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The Politics of Industrial Policy

The Case of Malaysia's National Automotive Policy

The Politics of Industrial Policy:
The Case of Malaysia's National Automotive Industry

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Declaration

I declare that the work in this dissertation was carried out in accordance with the requirements of the University's Regulations and Code of Practice for Research Degree Programmes and that it has not been submitted for any other academic award. Except where indicated by specific reference in the text, the work is the candidate's own work. Work done in collaboration with, or with the assistance of, others, is indicated as such. Any views expressed in the dissertation are those of the author.

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Abstract

This thesis explores the politics of the industrial policy-making process in Malaysia, specifically in the national automotive policy (NAP). The automotive sector is one of the sectional interests under the heavy industrialisation programme introduced by the long-serving ruling coalition, the United Malay National Organisation (UMNO) led by Barisan Nasional (1963-present). Often in Malaysia's policy-making process, the government manages the need for modernising the country through industrial development. It also responds to the domestic political economy including to political pressure, domestic enterprise interest and ethno-economic development. This highlights the need to understand the dynamics of the politics behind its policy-making process. To uncover the politics of the national automotive policy, this study seeks to explore what institutional arrangements evolve around the national automotive policy and how the state elite (politicians and bureaucrats) and 'selected' business groups mobilise, coordinate, and prioritise resources and economic preferences in the policy-making institutions.

This research utilises the theory of institutionalism along with a developmental state approach to develop a theoretical framework to explore and make sense of the politics in Malaysia's policy-making process. This study employs a qualitative, interpretivist method. Primary data were collected by means of interviews with elite policy actors. Secondary data were also used as part of empirical evidence. The findings show that the political elite have a paternalistic role in policy decisions. As a consequence, the political elite can assert policy preferences along with the interest of the Bumiputra industrialist class. The empirical findings also suggest that though the formation of the NAP was part of an effort to liberalise the domestic automotive sector to create a level playing field environment, various institutional arrangements are in fact made to protect the domestic enterprises' interests. The terms of policy have limited pro-market reforms. The reciprocal relationship between policy actors and 'selected' business enterprises enable them to configure and interpret policy in a way that favours their interests. Domestic automotive enterprises have benefitted from various state resources through beyond arm's length relationships. Furthermore, the ethno-economic consideration (i.e. Bumiputra interest) is 'packaged' in the policy as part of protecting the domestic automotive sectors. This study shows how political influences in the automotive sector are crucial to facilitate the growth of Proton, the country's flagship national car manufacturer, though they have a constraining effect on the direction of the national carmaker. Political consideration and ethno-nationalist interest have generally limited the growth of Proton.

Overall, this study shows that existing institutional structures influenced by historical events, political factors, power relations and norms have enabled a 'triangular arrangement' between state elites (politicians and bureaucrats) and 'selected' enterprises to formulate policy. Institutional arrangements made by these actors reveal the complex relationships and interactions among elite policy actors to influence the policy-making process. Often, political consideration precedes economic rationale. This has implications on policy-making institutions, which in turn affects their developmental strategy.

Dedication

I praise Allah s.w.t. may He be glorified and exalted because of His great favours, blessing and guidance that He has bestowed upon me to complete my PhD journey. To my loving wife, Anjali Halimah Frances Gilong Avriett, your unconditional love, patience, perseverance, care and sacrifice has made this journey possible. Throughout the PhD journey, you have always been there for the family in ups and downs. You never give up motivating and supporting me in this life changing journey. I love you. My three sons Farish, Harvey and Afleigh, you are the perfect gift from god and the best thing ever happened to our life. All of you have brightened up the journey over the years and always be the angel of my heart.

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List of Acronyms and Abbreviations

AAF	ASEAN Automotive Federation
ADF	Automotive Development Fund
AFC	Asian Financial Crisis
AFTA	ASEAN Free Trade Agreement
AMCC	American-Malaysia Chamber of Commerce
ANCAP	Australasian New Car Assessment Program
AP	Approve Permits
ASEAN	Association of Southeast Asian Nations
BCIC	Bumiputra Commercial and Industrial Community
BN	Barisan Nasional
CBU	Complete Built Up
CEPT	Common Effective Preferential Tariff
CIF	Cost, Insurance and Freight Charges
CKD	Completely Knocked Down
Danaharta	Pengurusan Danaharta Nasional Berhad
DRB-HICOM	Diversified Resources Berhad - Heavy Industries Corporation Malaysia
EEV	Energy Efficient Vehicles
EOI	Export Oriented Industry
EPU	Economic Planning Unit
ERP	Effective Rate of Protection
FELDA	Federal Land Development Authority
FDI	Foreign Direct Investment
GATTS	General Agreement on Tariff and Trade
HICOM	Heavy Industries Corporation Malaysia
IAF	Industrial Adjustment Fund
ICA	Investment Co-ordination Act
ILP	Industrial Linkages Program
IMF	International Monetary Fund
IMP	Industrial Master Plan
ISI	Import Substitute Industrialisation
JV	Joint Venture
LMCP	Local Material Content Program
MAA	Malaysia Automotive Association
MACPMA	Malaysian Automotive Component Parts Manufacturers
MAI	Malaysia Automotive Institute
MARA	Majlis Amanah Rakyat or the Council of Trust for the Indigenous Peoples
MCA	Malaysia Chinese Association
MDI	Mandatory Deleted Item
MDP	Mandatory Deletion Program
MFN	Most Favoured Nation
MICC	Malaysia International Chamber of Commerce
MIC	Malaysia Indian Congress
MIDA	Malaysia Investment Development Authority
MITI	Ministry of International Trade and Industry
ML	Manufacturing Licensing
MMC	Mitsubishi Motor Company
MOBNAS	Mobil Nasional Indonesia

MoF	Ministry of Finance
NAP	National Automotive Policy
NDP	National Development Plan
NEP	New Economic Policy
NYT	New York Times
OEMs	Original Equipment Manufacturers
OICA	Organisation Internationale des Constructeurs d'Automobiles
OJT	On Job Training
PEKEMA	Persatuan Pengimport dan Peniaga Kenderaan Melayu Malaysia/ Malaysian Association of Malay Vehicle Importers and Traders
PEMANDU	Performance Management and Delivery Unit
Perodua	The Perusahaan Otomobil Kedua/ Second Automobile Manufacturer
PMO	Prime Minister Office
Proton	Perusahaan Otomobil Nasional/ National Automobile Company
PVA	Proton Vendor Association
R&D	Research and Development
REM	Replacement Parts and Component
SME	Small and Medium Enterprises
SOEs	State Owned Enterprises
TEL	Temporary Exclusion List
TRIMs	Trade-Related Investment Measures
UMNO	United Malay National Organisation
UNCTAD	United Nations Conference on Trade and Development
VDP	Vendor Development Program
WSJ	Wall Street Journal
WTO	World Trade Organisation

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Chapter 1

Introduction

1.0 Overview of Malaysian Industrial Development

Industrial development in Southeast Asia has been and continues to be debated with interest among political economists. The strategy and policy of industrial development is widely discussed in the literature, and most scholars agree that the economic development of this region should not merely be viewed from neoliberal perspectives (property rights, enforcement of law, a favourable investment climate) (World Bank, 1993; Rasiah and Yun, 2009; Lall, 1994; Hill et al., 2012; Chang, 2003). Industrialisation approaches tend to be mixed with a market-based approach and the strategic role of the state. The former approach is prevalent among Southeast Asian countries, given the vast Foreign Direct Investment-led industrialisation (Jomo, 2002; Chang, 1999), but government intervention also exists in selected sectors. Though this region has not enjoyed 'miracle' growth like Northeast Asia (except Singapore), it has made significant transformations. Malaysia, one of the largest economies in Southeast Asia, has attained significant economic development and structural change since its formation in 1963.[1] Rapid economic development has been and remains the overriding policy objective. Industrialisation has become one of the central considerations in modernising the country's economy. This is the main reason that Malaysia has effectively transformed from primarily commodity-dominated activities to an industrial-based economy.

Economic development is one of the key policy discourses in Malaysia. Industrialisation occupies a central position on the economic policy agenda. Industrial policy is devised for industrialising the country and has undergone several phases[2] over the past decades. During the post-colonial period (1958 – 1969) industrial policy favoured Import Substituting Industrialisation (ISI) in seeking to expand the domestic industrial base and encourage learning-by-doing (Jomo, 1993; Tan, 2014). This was part

[1] Prior to the formation of Malaysia, Malaya (later known as Peninsular Malaysia or West Malaysia) attained independence from the British in 1957. Six years later in 1963, Malaysia was formed with the inclusion of the Borneo states of Sabah and Sarawak. Later, in 1965 Singapore was excluded from the Federation of Malaysia (Jomo and Wee, 2014).

[2] The phases of Malaysia's industrial development draw from the work of Jomo (1999), Jomo and Edward (1993), Jomo and Wee (2014), Menon (2008), Lall (1995) and Rasiah (2011a).

of economic diversification efforts to reduce over-reliance on commodity activities like rubber and tin (Jomo, 1993). The ISI subscribed a structuralist approach, making the role of government more like a promotional tool geared to the provision of an investment climate favourable to private and foreign private companies (Wheelwright, 1963, p.69). The industrial policy at this stage was to provide tax exemptions, infrastructures and imposition of tariff protections. Though ISI increased manufacturing activities[3] (mainly dominated by Chinese-owned firms), it was limited by the small domestic market (Rasiah, 2011a). The policy failed to move beyond basic manufacturing assembly activities, and little productions went into the export market (Jomo and Edward, 1993). Import of capital and intermediate goods rose rapidly between the year 1963 – 1968 consequently aggravated balance of trade. ISI, unable to absorb excess of labour, led to high unemployment. The economy faced income disparities and high poverty incidence across ethnic groups (Lall, 1995).

The industrial policy shifted to Export Oriented Industrialisation (EOI) from 1970-1980, facilitated by the global production network relocating activities to developing countries (especially the semiconductor industry). The Investment Incentive Act 1968was enacted and established the Free Trade Zone (FTZ). The EOI strategy was to promote FDI-led export manufacturing activities and to create linkages and upgrading. Export activities mainly attract FDI labour-intensive industries and firms were given lucrative tax exemptions. Restricted labour rights were also part of the policy to attract FDI (Jomo, 1993). Vast relocation of foreign companies has facilitated (i) export activities, (ii) employment rates, (iii) the transfer of low-mid technology in manufacturing, (iv) utilisation of raw material, and (v) building linkages with domestic industry in the manufacturing sector. Malaysia's manufacturing grew rapidly, particularly in the electronics and electrical sectors, as well as in the textile and clothing industry (Rasiah, 2011). However, the EOI strategy constrained the growth of industrial development. The manufacturing activities did not move up the value chain due to lack of effective linkages with foreign companies. This resulted in industrial dualism, where a foreign company controls high technological activities while the domestic firms are restricted to assembly and subcontracting (Tan, 2014). Recognising this problem, the government prompted a shift from low-mid tier activities characterised by labour intensity to more capital-intensive activity (Menon, 2008).

In 1970 the government introduced the New Economic Policy (NEP) in wake of the racial tensions in 1969[4]. The policy had a two-pronged goal of alleviating poverty and restructuring society. The effort

[3] ISI has increased the number of industries coming into operation in manufacturing activities such as basic metal, electrical machinery, car assembling and plastic industries. Though they are characterised as low-end industrial activities, ISI managed to reduce the over-reliance on raw material extraction activities such as tin and rubber (Rasiah, 2011a).

[4] Economic inequality was expressed in a communal sense, which led to a racial riot on 13th May 1969. The problem of inequality and income disparities was due to colonial structures in economic activities. The

to 'restructure society' sought to reduce inter-ethnic economic disparities especially for Bumiputra[5], by eliminating the identification of race with economic functions (Jomo and Wee, 2014). The NEP gave the state direct intervention in economic development. Industrial development has since been tailored along the need in the NEP to redress socio-economic inequality (Rasiah and Shari, 2001). Various state-owned enterprises were formed to facilitate the growth of Bumiputra entrepreneurs. The government also fosters the growth of Bumiputra suppliers in manufacturing activities. Bumiputra business groups are given strong preferences and special privileges in terms of financing, education, skills and training, and licenses, among others.

In the 1980's the government launched the second round of ISI strategy under the Fourth Malaysia Plan (1981 – 1985). This industrial policy earmarked a heavy industrialisation programme in which technological acquisition, industrial upgrading, and research and development (R&D) activity became a central part of industrial policy. The purpose of the heavy industrialisation was to develop indigenous technology capabilities. This was an attempt to shift to capital- and technological-intensive activity. The heavy industrialisation programme emulates South Korea and Japan in strengthening their industrial base. The Heavy Industries Corporation of Malaysia (HICOM) was established to diversify manufacturing activities and develop forward and backward linkages. The heavy industrialisation programme saw the growth of steel, cement, and more importantly, transport equipment and automotive sectors. Heavy industry enjoyed strong protections (tariff and non-tariff barriers) and subsidies. The government-sponsored heavy industry projects have had limited success due to long gestation periods, lack of performance monitoring and being internationally uncompetitive (Jomo and Wee, 2014). However, the heavy industrialisation programme was a 'push factor' to shift into technological-intensive activity. The programme also facilitated the creation of various domestic enterprises engaged in heavy industry.

The government continues to promote EOI under the Industrial Master Plan (IMP) versions I, II, and III. IMP I (1986 – 1996) provided a long-term development framework for resource and non-resource based industries. It further promoted export manufacturing sectors with an emphasis on technological deepening and human resource development. Various incentives and programmes were introduced such as the Promotion Investment Act 1986, the Intensification of Research Priority Areas programme,

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Bumiputra's main economic activities were mainly in agricultural activities, while the Chinese focused on commercial activities. The post-colonial government which emphasised the ISI strategy that somehow favours Chinese entrepreneurs made feeble attempts to increase participation of Bumiputra in economic activity. This has led to a serious gap between these two major ethnic groups.

[5] Bumiputra refers to the indigenous people in Malaysia. Most Bumiputra groups in peninsular Malaysia are known as Malay and are mostly Muslim by religion, though Sabah and Sarawak Bumiputra groups can be Muslim or non-Muslim.

the Technological Action Plan and the Industrial Technical Assistance Fund (Tan, 2014, p.159). This saw rapid expansion of manufacturing exports, and at its peak Malaysia became one of the largest exporters of manufacturing products (especially in the E&E sector) in Southeast Asia (Lall, 1995). The average growth rate of the GDP during the 1990s was 7.4 per cent, which was the highest the country ever achieved (Hill, 2012) before the Asian Financial Crisis in 1997. While expansion of exports is commendable, lower local contents fell short in moving up into higher value-added sectors, which shows the lack of industrial upgrading (Tan, 2014). Therefore, with IMP II (1996 – 2006) the government further emphasised technological upgrading by building linkages, R&D activities and infrastructure development. IMP II also emphasised a cluster-based manufacturing strategy to strengthen industrial development, including heavy industry and particularly automotive sectors. The industrial policy continues to attract the declining inflow of FDI, especially of the AFC.

Against the backdrop of the global competitions and pressure from emerging markets, IMP III (2006 – 2020) emphasises industrial catch-up into mature broad-based manufacturing activities and innovative and competitive sectors (MITI, 2006). This is due to slowed productivity levels associated with the lack of technological upscaling and relatively lower level of skilled workers (Rasiah, 2011; 2011a). Industrial policy thus focuses on gearing towards global competitiveness by moving up the global value chain, with emphasis on value-added and knowledge-intensive activity. The newly introduced New Economic Model of 2010 was targeted to spearhead economic transformation to a high-income nation by 2020, with emphasis on new sources of growth such as the service sector and ongoing support of high-value added manufacturing activities. The industrial policy continues to focus on rapid structural change in heavy industrial sectors to graduate into higher technological activities.

1.1 Background of the research

Most scholars have described the state's industrial policy as adopting market liberalism that emphasises trade, foreign direct investments and the role of the private sector in pursuit of an outward-oriented economy (Lall, 1995; Hill, 2012; Felker, 2015). The extraordinary continuity of the same ruling coalition, United Malay National Organisation (UMNO) led by Barisan Nasional (BN) (1963-present), managed to respond to the need for industrial development as part of modernising the country's economy. At the same time, the ruling coalition is able to respond to emerging demands such as ethno-nationalism, political pressures and domestic enterprises (Jomo, 1999, 1993; Jomo and Tan, 1999; Bowie, 1991; Jesudason, 1989; Chin, 2000). The ruling government's economic policy embodies market liberalism, whereby the role of the state is to maintain market mechanisms thereby ensuring a 'level playing field environment', such as the role of private enterprise and encouraging the FDI-led export strategy (Jomo and Edward, 1993; Menon, 2008). However, state actors are actively maintaining domestic enterprises' interests and a nationalist economic project, as this seems necessary to preserve political legitimacy. Therefore, there has been no complete 'rolling back' of the state, particularly in the policy-making process (Ghosh, 1999).

Introduction of a heavy industrialisation programme in the mid-1980s by Prime Minister Mahathir Mohammad is one of the turning points for Malaysian economic policy (Jomo, 2007; Rasiah, 2011a). The heavy industrialisation programme marked the state adopts developmentalist state approach. Briefly, such an approach is one in which the state puts economic development as its top priority and industrial policy is devised to attain developmental goals (Embong, 2015; Bagchi, 2006). The programme aims at deepening and diversifying industrial structure through building linkages and developing indigenous technology capabilities, particularly in the automotive sector. This is deemed strategic by the ruling elite, although there is limited comparative advantage (Abdulsomad, 1999). The formation of heavy industrial policy entails direct and indirect protective measures such as tariffs, import restrictions and licensing requirements to nurture the growth of domestic industrial groups in selective sectors (Rasiah and Ishak, 2001; Hasan and Jomo, 2007). Though the state adopts market liberalism, the presence of industrial policy (like the national automotive policy) means the state continues to have protective measures. The political economy of the industrial policy may appear to create a 'market friendly environment', but policy formulation is also designed to favour domestic enterprise (Lall, 1995; Embong, 2015).

Although heavy industry was intended to diversify and strengthen the country's industrial base, politically, the programme was part of a nationalist economic project (Lim, 1994). The underlying purpose was to allow Bumiputra to lead industrial development and allow for the creation of a Bumiputra Commercial and Industry Community (BCIC) (Embong, 1996, p.58). As stated earlier, the pro-Bumiputra agenda is an important consideration in economic policy. This 'ethnic imperative' is part of New Economic Policy objectives—restructuring society by reducing economic inequality among races (Jesudason, 1989). Therefore, the Bumiputra agenda is a significant part of the economic policy-making process. The NEP has formed a policy legacy for 'guiding principles' in Malaysia's economic policy (Menon, 2008; Gomez, 2016).

In this sense, the formation of industrial policy in Malaysia cannot be separated from politics. This is due to the strategic role of the state in policy making while adapting the domestic political economy, specifically the national automotive sector. Policy formation and implementation largely coincide with political interests and economic considerations. These two sets of interests tend to intertwine between state actors: on one hand, to preserve political legitimacy and the Bumiputra class interest, meaning the state requires a certain degree of economic control over the marketplace. On the other, industrialising the country requires a market-friendly environment (liberalisation) to create a competitive economy. Often there is an economic efficiency trade-off when economic development is embedded with political considerations (Tan, 2015; Lim, 1985). However, this does not mean industrial development is not attainable. In fact, the strategic role of the state in Malaysia is to transform industrial structures, revealing the institutional capacity of the ruling elite in policy-making institutions to formulate and implement industrial policy (Smogyi, 1991; Bowie, 1991).

Industrial policy is a political process. It is inherently subject to conflicts of interest, power relations, coordination, and the influence of historical events (Leftwich, 2000; Haggard, 1998). Industrial policy under the heavy industrial programme in Malaysia reveals the ability of the state to impose its will to achieve economic transformation. The ability of the state to impose its will is subject to the capacity of political institutions and the bureaucracy to express their industrial preferences in policy making (Haggard, 1998, p.78). However, this capacity does not exist in a vacuum because economic transformation is grounded in the state and society mobilising resources. The ability of state actors in Malaysia to shift resources into heavy industry raises several questions: How are policy actors autonomous? How are power relations structured between state and society? How does this happen? Why are certain industrial sectors preferred over others? These questions are subject to the specific context of the domestic institutions (Brodsgaard and Young, 2000). Therefore, this requires a closer look at the politics of industrial policy-making processes in Malaysia, where history, power relations, political processes and normative aspects influence policy formation.

In discussions of policy making, especially interactions between and capacity of the policy actors (Painter and Pierre, 2005), the role of *institutions* that constitute the 'rules of the game' (North, 1991; MacIntyre, 2003) is highlighted. Most institutionalist scholars have highlighted that national industrial development adopts different industrial policies and outcomes (Chang, 1999; Thelen, 1999; Hall and Taylor, 1994; Campbell, 1997a; Steinmo, 2008) due to the variations of institutional settings, which are rooted in domestic factors that shape and constrain policy actors' interactions. The nationally-bound institutions influence preferences, ideas and the allocation of resources in policy-making institutions (Whitley, 2003).

1.2 Rationale of the Study

This research aims to explore and understand the political reality of Malaysia's industrial policy-making process. However, there is scant attention in Malaysian literature on the politics of industrial policy, particularly the role of institutions (Doner, 1992; Doner and Ramsay, 2003; Leigh, 1993). Most discussion of industrial policy focuses on analysis of the policy outcome with neo-classical perspectives (Alavi, 1996; Lall, 1995). Analysis of policy also leans towards quantitative measures (Rasiah, 2011a; Tham, 2004; Mat Zin and Shadan 2009; Athukorala, 2004, 2010). This does not give deep insight into the political reality of policy-making institutions. There is limited analysis of what takes place 'behind the scenes'. These limits provide the motivation to understand the politics behind policy-making institutions in Malaysia, specifically relating to national automotive policy, which forms a crucial part of the heavy industrialisation programme.

Most research in the area of the political economy of industrial policy making in Malaysia focuses on a developmentalist state approach (Embong, 1995; Abbott, 2003), an ethnic approach (Jesudason, 1989; Hircshman, 1986; Brennam, 1982), class-based analysis (Jomo, 1986; Lim and Canak, 1981; Lim, 1985), patronage in economic policy (Gomez and Jomo, 1997), rent-seeking (Searle, 1999; Tan, 2008; Khan, 2000) and leadership and policy making (Leong, 1992; Milne and Mauzy, 1999). Such scholarly work has contributed valuable insights into the politics of industrial policy using different theoretical lenses. However, there has been less attention paid to the role of institutions in policy making (Aun, 2002; Tipton, 2009). Linder and Peter (1999) argue that institutions seldom play a distinct role in policy making, when in fact institutions shape capacity, belief systems, preferences and interactions that facilitate or constrain policy processes. The presence of the patronage system, rent-seeking behaviour, the dominant role of elites in policy institutions and the nexus of ties between the state and market all exist because of the domestic institutions that enable and support such interactions.

Pertinent to Malaysia's institutional context, the institutions enable the political elite, bureaucracy and other economic agents, the capacity to define industrial preferences in policy-making. Hence, elite policy actors can prescribe and guide the decisions and actions of policy makers to realise industrial policy (Felker, 1999; Noh, 2010; Aun, 2002). This also sets the boundaries of interactions between economic actors, including how the state elites and industrial groups 'get things done' by advancing their political and economic interests in the institutions they are embedded in. Therefore, this research aims to bring institutions to the forefront in analysing the politics of industrial policy formation to begin filling in the gap in the literature. In particular, this research focuses on Malaysia's national automotive policy.

For late industrialising countries like Malaysia that adopt a developmentalist state approach, the policy-making environment tends to be unequal (Tan, 2009). The dominant role of the state elite (politicians and bureaucrats) and selected business groups in policy formulation limits other economic actors to advance their interests. Haggard (1998), Abbott (2004), and Horowitz (1993) point out that there is a need to focus on the institutional arrangements between policy actors. Institutional arrangements that are part of the coordination of policy making are subject to wider institutional constraints (for example, power relations and historical events). Such constraints also shape how policy actors advance their preferences in policy institutions (Fox and Miller, 1995). The coordination of policy making has to pay close attention to the relationship between state elites (politicians and bureaucrats) and selected business groups, as this path dependency was embedded in the institutions during the early period of industrialisation.

Leigh (1992) analysed economic policy reforms in Malaysia and has suggested that changes in Malaysian economic policy are best explained by reference to the 'alignment' of the relationship between political, bureaucratic and business elites. Economic policy changes are related to these three core elites' interactions (p.122). Similarly, Leong (1992) analysed the economic policy environment in Malaysia and also claimed that creating a policy window for reforms in Malaysia's economic policy needs to take into account the arrangements of the state elites and selected business communities (p.223). Therefore, it is in the interest of this research to analyse the interactions and arrangements of the 'triangular arrangement' (political elites, bureaucrats and 'selected' business groups) in coordinating policy interests. The interaction of these actors highlights the dynamic politics of policy-making institutions. This research will also address the gap in Malaysian literature on the 'triangular arrangement' in policy-making institutions, particularly in terms of national automotive policy.

1.3 Ethnics Politics of Malaysia

The political economy of Malaysia's industrial development could not ignore the ethnic aspect in policy-making. Although Malaysia is a plural society (Khoo, 2009), ethnic considerations have been and continue to dominate the political economy of economic development (Yusof and Bhattasali, 2008). The dynamic of ethnic politics behind the policy-making process have strongly influenced policy preferences, particularly the interests of the Bumiputra (Hirschman, 1986). It is a central task for political elites to deal with ethnicity issues in relation to industrial development. Ethnic consideration (Milne and Mauzy, 2006) is deeply embedded in Malaysia's institutional setting. Ethnic considerations and industrial development are intertwined in the country's institutions, hence having influenced the configuration of developmental strategy.

As historically structured institutions (Thelen and Steinmo, 1992), historical factors have shaped the concern over ethno-economic development. Most scholars who work on Malaysian politics have observed that the 'ethnic imperative' has historical roots (Brennan, 1982; Bowie, 1990; Embong, 1999; Aun, 2004; Noh, 2013; Milner, 2014;). The historical factors especially during the colonial period, which practiced 'divide and rule', have inevitably given rise to ethnic politics, which became more dominant and aggressive during the post-colonial period. The 'divide and rule' concept has led to uneven demographic balance. In general, during the colonialist rule the Bumiputra community focused on small-scale agricultural activities, the Chinese ethnic group focused on commercial activities and the Indians mainly worked in the rubber plantations. Nair (2009, p.88) pointed out that the division of labour reflects specialisation among the three dominant ethnic groups, and this has created economic functions by race. In such a division of labour, the main beneficiary is the domiciled Chinese ethnic group that was involved in the commercial activities of British companies. This group thus has had a better advantage in wealth accumulation as compared to other ethnic groups (Jesudason, 1989). While Bumiputra peasants worked on agricultural activities, the Bumiputra aristocrats (Sultan/landlord/noble) were given special roles and privileges under the colonial rule. The roles were confined to religious and cultural affairs, while some aristocrats are taken as civil servants. These aristocrats were utilised by the British in maintaining control, and at the same time the aristocrats became dependent upon the colonialists for economic development (Brennan, 1986, p.194).

The compartmentalisation under the colonial rule has led to less opportunity for social integration (Cheah, 2009). Maintaining a less integrated society was done partly to avoid unity among the ethnic groups that could possibly cause threats to the colonialist rule. Integration could also disrupt the economic activities of the British companies (Emerson, 1970). However, the consequences of avoiding social integration and maintaining economic specialisation based on identification of race have led to strong ethnic consciousness and ethno-nationalism today, particularly in the indigenous group that is the Bumiputra (Nair, 2009; Ghee, et al., 2009). Interethnic animosities started to grow gradually, and though there were some uprising incidents driven by the ethno-nationalist movement, they were always curbed by the British administration. Economic imbalances between ethnicities continue to incite animosities today, especially for the native Bumiputra or Malay who are economically disadvantaged.

When the plan of independence arrived in late 1950s, the most important aspects in attaining independence were elections and the formation of political parties. The condition for independence was to ensure that the political organisation would be able to form an 'ethnic coalition' among the main dominant ethnic groups: the Bumiputra (Malay), Chinese and Indian. During the pre-independence period, the three main political parties that were created include the United Malay National Organisation (UMNO), the Malaysia Chinese Association (MCA) and the Malaysia Indian Congress (MIC). These political parties were able to develop a feasible political arrangement and build consensus (Yusof and Bhattasali, 2008; Mauzy, 1983). Among other political arrangements, this included power-sharing between the ethnic-based political parties. The power sharing mainly was created to ensure the ethnic-based political parties were able to bargain and negotiate their ethnic interests in order to build interethnic cooperation. Some important features in building interethnic cooperation include building consensus on political aims, citizenship and improving the economic status of the Bumiputra (Mauzy, 1983). Together, the three political organisations formed a political coalition called the Alliance party (this was the ruling coalition of the country until it changed to Barisan Nasional in 1973). In the first general election in 1955 the Alliance party gained a majority of seats, winning 51 of the 52 seats contested. The Alliance party played a crucial role in negotiating the transition from British rule to independence. The Alliance party also played an instrumental role in negotiating with the two Borneo states, namely Sabah and Sarawak, to form Malaysia in 1963 (Liow and Leifer, 2014).

During the post-independence period there was serious inter-ethnic economic inequalities. Although leadership during that period made some effort at socio-economic reforms, there was no serious attention to redress the economic disparities between races (Nair, 2009). The Bumiputra community suffered the most from serious income inequality and poverty. While the focus in that period was to maintain a business-friendly environment for foreign companies, such approaches did not improve the economic status of the Bumiputra community (Jomo, 1999). The Alliance government did not have a comprehensive strategy to incorporate the Bumiputra group into the wider economic activities. Instead, the domiciled Chinese community group had the upper hand because of their involvement with the production chain with foreign companies (Jesudason, 1989; Rasiah, 2011a). Since the political arrangement was made to secure ethnic interests, leadership during this period retained the economic interest of the Chinese community. In return, the Chinese business group helped to politically finance through MCA and channelled money to UMNO to maintain political affairs of the

Alliance party (White, 2003). Over the years, the income inequality has widened among the ethnic groups, and the general Bumiputra community has made little advancement in participating in economic activities (Embong, 1996). In an effort to increase the Bumiputra participation, the postcolonial government has set aside funds for a Bumiputra development strategy (Jomo, 1999). This has included the formation of Majlis Amanah Rakyat or the Council of Trust for the Indigenous Peoples (MARA), the Federal Land Development Authority (FELDA), and Bank Bumiputra, all of which were part of the government initiatives to foster Bumiputra entrepreneurship. Various credit facilities and projects are also offered to the Bumiputra community; however, the economic activities are limited to small rural industries (Farouk, 2012). Such efforts do not improve the Bumiputra economic status or address poverty among the natives.

Interethnic elite cooperation was crucial to maintain state power and government administration. It was the interethnic bargaining that ensured the economic policy was implemented. However, lack of economic participation among the Bumiputra groups has incited ethnic animosity towards the non-Bumiputra, especially against the Chinese community (Jomo, 1990). The commercially weak Bumiputra group started to express dissatisfaction with their economic status along with communalist sentiments. The Bumiputra community has also pressured the government to take a more aggressive role in facilitating the community's participation in commercial and industrial activities. Pressure has also come from UMNO members to force top leadership to prioritise the needs of the Bumiputra groups. Despite mounting pressure, the government only made feeble attempts to address the Bumiputra group's interests. Scholars have observed that the top leadership of UMNO had some resistance to addressing the economic opportunity among the Bumiputra community because the Alliance party in the mid-1960s did not intend to intervene in the economy. They wanted government to play a limited role in the market in order to maintain the interest of the British companies and preserve the Chinese business groups' interest, which were the main political financiers (White, 2003; Jesudason, 1989).

Since there was limited effort to address ethnic economic disparities, discontent with the economic imbalance expressed through strong communalist sentiment led to a racial riot in 1969. The riot led the government to declare a state of emergency and a suspension of Parliament. This dark episode in the history changed the political governance. The Alliance party was dissolved and a new political coalition called the Barisan Nasional (BN) was formed. The BN was still comprised of the main component parties UMNO, MCA and MIC, some former opposition parties also joined the coalition. Although this new coalition maintained interethnic accommodation, it had new political governance ('rules of the game') where racial lines become overriding objectives (especially for Bumiputra) in economic development (Menon, 2008; Crouch, 1996; Lall, 1995). With UMNO now the dominant component of the coalition and representing Bumiputra interests, the party was seen as a crucial political party to bring development for the Bumiputra community. As such, the institutional setting structured political elites within UMNO to play a dominant role in proposing economic development policy (Yusof and Bhattasali, 2008). Though BN may appear to be an 'ethnic coalition', in reality it lost its power-sharing characteristic due to UMNO hegemony (Ramasamy, 2009). UMNO political elites thus had the capacity to dictate policy interests by playing with ethno-nationalism along with religion.

As stated in the earlier section, the New Economic Policy (NEP) was introduced after the racial riot. This policy marked a new milestone in Malaysia's socio-economic development plan (Crouch, 1996). The NEP sought to address socio-economic conditions for national unity by reducing economic imbalances between the Bumiputra and non-Bumiputra groups. A poverty reduction programme and restructuring of society were the two main objectives to resolve the economic disparities. These efforts were made to reduce animosity among the Bumiputra community who were deprived of economic opportunities. The NEP thus brought about a preferential policy or positive discrimination policy (Jomo, 1990; Mohamad, 2009). Preferential policy gave rise to Bumiputra policy, where emphasis on socio-economic policy was squarely linked to the Bumiputra group's interest. The Bumiputra interest became an important policy discourse in configuring policy preferences. It became institutionalised, hence Bumiputra interest came to structure policy options. This gave the political elites, especially UMNO elites, the power to dictate state resources and develop terms of policy to facilitate the growth of the Bumiputra community.

On the economic front, the Bumiputra policy's purpose is to facilitate the community in becoming incorporated into the mainstream of economic development. This means that policies are devised to create opportunity for the native group to raise their socio-economic status. The government wanted to create Bumiputra business groups and they played a strategic role in industrialisation and national development (Embong, 1996, p.58). Creating new business groups with racial undertones meant that the government shifted resources in order to allow the interest of 'selected' private enterprises (particularly Bumiputra groups) to grow in the marketplace. Such government intervention would sideline the productive group's interest because new 'selected' enterprises were being prioritised in the marketplace using state resources (Jomo, 1990). To aid the new Bumiputra business groups, government provided preferential access to expansive credit facilities and subsidies to Bumiputra groups (Embong, 1996). This was done to foster entrepreneurship and included various training institutions to nurture entrepreneurial skills (Searle, 1999). Considerable state resources were allocated to facilitate the growth of the Bumiputra business community.

At the same time, the NEP also set long-term targets to increase Bumiputra ownership in corporate sectors and enhance the proportion of Bumiputra employed in manufacturing sectors and managerial positions. The NEP targeted to increase Bumiputra shares in corporate assets from 2 percent in 1970 to 30 percent in 1990. The policy also aimed to have the employment pattern in the urban sectors represent the racial composition of the country (Menon, 2008). The Investment Co-ordination Act (ICA) of 1975 was introduced as part of increasing the Bumiputra equity in corporate sectors (Yasuda, 1991). The ICA was one of the most controversial acts, as it regulated that corporate shares must have at least 30 percent Bumiputra shareholders. However, during the world commodity crisis in the 1980s the government loosened the terms of the ICA (Embong, 1996).

After the formation of the NEP the country saw partial abandonment of its laissez-faire policy (Jomo, 1999; Rasiah and Ishak, 2001). The government became in favour of state intervention, and as Rasiah and Ishak (2001) point out the formation of the NEP made the state play a strategic role in the market. The state established a considerable number of public enterprises (sometimes in collaboration with private sectors) as part of accumulating Bumiputra business groups. The state also coordinated public resources allocations into public sector ownership and took control of business enterprises. A substantial amount of public development expenditures to promote the growth of state-owned enterprises ranged from 4.6 billon in the 1970s to 104 billion in the 1990s. More than 1000 state-owned enterprises (SOEs) were formed to engage in a variety of economic activities and entrepreneurial training for Bumiputra (Jomo and Wee, 2015; Tan, 2014). The over-expansion of SOEs also created a powerful 'Bumiputra bureaucratic-capitalist elites' group who had close ties with the ruling political elites. This bureaucratic elites group largely influenced government budget allocations and the making of policy adjustments (Searle, 1999; Bowie, 1991). This group also became the main beneficiary in the later phase of the privatisation plan due to their close relationship with the political elites (Tan, 2008; 2012).

From a political aspect the Bumiputra policy is an important political discourse for the UMNO-led BN's political legitimacy (Searle, 1999). While ethno-economic development is crucial, it intertwined with the ruling elites' political interest. Scholars have observed that even though the NEP had a strong emphasis on Bumiputra development, which was necessary, the Bumiputra policy has also been used by political elites to sustain their political power (Felker, 2003, 2015; Gomez, 2008, 2009, 2012; Tan, 2008; Gomez and Jomo, 1997; Bowie, 1991; Jomo, 1990, 1999). Brennan (1982) suggested that using ethnicity issues can transcend to most Bumiputra classes, hence using the Bumiputra issue is a convenient way to garner political support. Political elites have constantly used the ethnicity discourse to remain in power and to describe themselves as the force responsible for bringing development to the Bumiputra community.

Emphasis on ethno-economic development like the Bumiputra policy promoted a political culture of patronage (Gomez and Jomo, 1997; Tan, 2008). Since the NEP's goal was to promote Bumiputra participation in the economy, the political elites had the capacity to devise preferential access to economic rents (licences, permits, subsidies and credit facilities) for Bumiputra business groups. Though this was done to facilitate Bumiputra participation in commercial and industrial activities, it also created political patronage, especially for those Bumiputra business groups so dependent on state resources to grow. The unintended consequences of this Bumiputra policy has created what Ramasamy (2009) describes as a huge patronage machine, where political elites and Bumiputra business groups use each other as means to advance political and economic interests. That is, political elites devise economic rents for closely linked individuals or groups, and in turn the Bumiputra groups provide political support.

In short, the Bumiputra policy is now deeply institutionalised in the policy-making institutions. The ethnic consideration has become a 'rules of the game' policy for the ruling elite to mobilise and coordinate resources. It is now inevitable that any industrial developmental strategy requires consideration of the Bumiputra interests. This includes the heavy industrialisation projects where the political elites developed a more aggressive industrial policy to create Bumiputra industrialist groups to lead the industrialisation program of the country (Gomez and Jomo, 1997). The ruling elites have utilised the Bumiputra policy as part of promoting industrial development but also as a precept to sustain political legitimacy.

1.4 The Case: National Automotive Policy

The selection of Malaysia's National Automotive Policy (NAP) of 2006 is crucial because it is linked to the heavy industrialisation programme. The heavy industry project shows that the state has adopted a developmentalist state approach to modernise the country's economy and to diversify industrial structures. The government has a considerable interest in this state-led industrial development. Whenever the state interest is accounted for in industrial development, it creates a political dynamic in the policy-making process wherein state elites and their 'selected' private enterprise alliances attempt to preserve their interest (Whitefield and Therkildsen, 2011). The national automotive policy in Malaysia reveals the institutional capacity of the policy actors in expressing their preferences (Doner, 1992; Ritchie, 2004, 2005, 2009). Though the automotive sector is a state-led industrial development project whereby the state intends to facilitate the growth of the domestic automotive industry via protective measures, the formation of the NAP 2006 is considered to be the Malaysian government's initial pro-market reform to enhance competitiveness. In this sense, a freer marketplace is expected along with removal of trade barriers (MITI, 2014; Natsuda et al., 2013; Wad and Govindaraju, 2012; Segawa et al*.,* 2014; Natsuda and Thoburn, 2014). The NAP is also one of the policy thrusts of the third Industrial Master Plan (IMP III 2006-2020) meant to achieve an 'industrialised nation' status in line with the 'Vision 2020' agenda (Li and Imm, 2007).

The NAP sets the country's strategic priorities and long-term developmental goals for the national automotive industry. The overarching goal is to liberalise the domestic automotive industry in order to improve the capability and competitiveness of the automotive industry in the ASEAN region and in global production. To achieve this end, the policy had six main objectives: (i) promote a competitive and sustainable domestic automotive industry; (ii) develop a regional hub for Energy Efficient Vehicles; (iii) increase value-added activities while continuously developing domestic capability; (iv) increase exports of vehicles, automotive components, spare parts and other related products in the manufacturing sectors; (v) increase the participation of Bumiputra companies in the domestic automotive industry; and (vi) safeguard consumer interest by offering safer, better products (NAP, 2014, p.1).

The policy acknowledges the problems of the domestic automotive industry, including lack of economies of scale, high production costs, lack of technological upgrading and knowledge application, non-optimised supply chains and lack of development of human capital. The policy attempts to increase competitiveness in order to address structural problems (NAP, 2014, p.5). The policy also advocates a transformative strategy for the national carmaker to be competitive in global automotive production. The policy puts special emphasis on the flagship Malaysia carmaker, Proton, though Proton has been labelled a huge liability due to its poor export performance, shrinking sales volumes and poor technological innovation (Rasiah, 2009; Kim, 2004). However, Malaysia is the only Southeast Asian nation and the only Islamic country that produces and designs its own national car (Rosli, 2006; Natsuda et al., 2013). The made-in-Malaysia car project Proton[6] was the first state-sponsored heavy industrialisation programme in the 1980s (Rasiah, 2011a) and it has been labelled a 'national

[6] Other national car projects include a joint collaboration with Japanese Daihatsu Motor Co. (Perodua), a heavy vehicle company (Malaysian Bus and Truck, MTB) which was set up in 1994, a motorcycle manufacturer (MODENAS) in 1995, and a light vehicle commercial manufacturer (INOKOM) in 1997 (Wad and Govindaraju, 2011).

champion product' (Case, 2012). The purpose of introducing the national car project was a government strategy to spur industrial development.

The national car project is the brainchild of the fourth Prime Minister Mahathir Mohammad. The formation of the national car project is deemed one of the strategic segments of heavy industry to build linkages, promote technological upgrading, improve value-added activities in manufacturing sectors and generate employment (Jomo, 2007; Abdulsomad, 2003). The industry has the potential to drive industrialisation because it involves complex and sophisticated production processes and components, and includes a wide range of specialisation. It is part of the strategy to rationalise the automotive market previously dominated by foreign automakers (Abdulsomad, 1999). The national car project also further creates and strengthens local parts and components manufacturers. At the same time it pursues the government agenda of 'industrial nationalism' (Jomo, 1993; Wad and Govindaraju, 2012 p.153) to enable the domestic automotive enterprises to lead manufacturing activities with little dependence on foreign companies. This is similar to Northeast Asia's approach, including Japan and South Korea, during the formative years of industrial development (Rasiah, 2011a). The heavy industrialisation programme also linked to the formation of Bumiputra industrial groups (Embong, 1996; Tan, 2008).

After the introduction of the heavy industrialisation programme the government employed selective interventions, particularly in the automotive industry, with heavy protection through tariff barriers. These included high import duties for foreign cars and non-tariff barriers such as manufacturing licensing, approve permits, and subsidies to enable the infant industry to grow despite being considered a sunset industry at the time (Smith, 1994). Various programmes were introduced to facilitate the growth of the national carmaker, including a localisation policy and vendor development programmes (to nurture entrepreneurial skills for Bumiputra SME in the automotive production network) (Rosli and Kari, 2008; Alavi, 1996; 1999). The made-in-Malaysia car—Proton and, later, Perodua—dominates the domestic automotive market which was previously controlled by Japanese auto companies.

Over the years, Malaysia's automotive industry has come under the pressure of liberalisation, especially after the country became a member of WTO in 1995 and made the commitment to Common Effective Preferential Tariff (CEPT) in 2002 under the ASEAN free trade agreement (AFTA) (Authokorala, 2014). Despite Malaysia's commitments promoting a market-based economy, the government has not necessarily 'rolled back'. Though the NAP's purpose was to structure a business friendly environment, the extent to which it is market friendly (providing a level playing environment) remains debatable. Given that state elites have substantial interest in the national car project and that it is linked to ethnic development, it is logical to argue that the government would facilitate the national carmaker (this includes Bumiputra vendors) beyond an arm's length relationship against the backdrop of pro-market reforms. Particularly, Proton is characterised as a 'national interest' that continues to depend on government financial support (Tong et al., 2012). The abysmal performance of the local carmaker in the export market, lack of technological upgrading, poor revenues and its debilitation by the Asian Financial Crisis and Great Recession, mean the liberalisation initiative is not done straightforwardly. Instead, the national automotive policy is coordinated by policy actors to protect the domestic automotive sectors (Mahidin and Kanageswary, 2004; Doner and Wad, 2014).

Liberalisation can undermine the growth of the national car project company which suffers from lack of competitiveness. Theoretically, a market-based approach (neoclassical reading) will weed out unproductive producers and replace them with productive ones. In the case of Malaysia's automotive industry, where there is substantial interest between the state elites and industrial groups who are in the automotive business and linked to state elites, opening up the market is not feasible because it can undermine domestic enterprise and ethno-nationalist interest. Therefore, understanding the NAP requires exploration of the politics behind the institutional arrangements of policymakers. Using a case study approach on the National Automotive Policy enables an in-depth empirical investigation and analysis of the institutional arrangements made by the economic actors in Malaysia. The empirical investigation seeks to understand the process of policy making within the institutional arrangements engaged in by the elites, including how they coordinate their interest in the policy-making institutions. This can reveal the politics of policy-making institutions in Malaysia.

1.5 Research Objectives and Questions

The purpose of this research is to explore the politics of policy-making institutions, specifically in regard to the national automotive policy (NAP). The automotive sector in Malaysia is one of the industries that is inherently political, given the state vested interest in the domestic automotive market. To explore the politics of the policy-making process, this thesis will be guided by two core research questions: *What are the institutional arrangements evolving around the national automotive policy? How do policy actors (between the tripartite elite policy actors) coordinate, mobilise, and* *prioritise resources and economic preferences in policy-making institutions?* Other sub research question in this thesis are as follows:

(i) *How are policy interest/preferences for the national automotive policy formed?*

(ii) *How are the institutions structured by the strengths and constraints of the elite policy actors in policy-making institutions?*

(iii) *How do elite policy actors respond to liberalisation pressures in the automotive sector in Malaysia?*

(iv) *To what extent has the role of policy actors facilitated the growth of Proton, and what are the constraining factors?*

This research will investigate the dynamic of politics behind the national automotive policy by assessing the interaction between political elites, bureaucrats and 'selected' industrial groups. The triangular arrangement of these actors have been crucial in coordinating policy arrangements (Ichimura, 1998; Woo-cumming, 1999). This research will utilise the neo-institutionalism theory (historical and sociological paradigm) and developmentalist state approach to understand Malaysia's policy-making institutions. Variations in institutional settings influence the organisation of policy actors, their interactions and their capacity in policy-making institutions, hence affecting policy formulation and direction (Painter and Pierre, 2005; Whitley, 2003; Hayashi, 2010), particularly in automotive policy. Integrating both approaches helps explain the political reality in policy processes, which remains limited in the literature (Moon and Prasad, 1994; Oğuz, 2013; Haggard, 1998; Kyle, 2017). Therefore, this thesis intends to contribute to the gap in the literature of the politics of policy-making institutions.

1.6 Structure of the thesis

This research consists of eight chapters. Chapter One explains the motivations for the research and the case study adopted, as well as why such interest and focus were developed. Chapter Two discusses the theoretical basis of this thesis. The theories of new institutionalism, institutional arrangements and a developmental state approach are presented. The identified theoretical themes are then integrated and developed as a theoretical framework used to explain, analyse and make sense of the politics of the policy-making process. Chapter Three presents the methodology. This chapter explains the methodological choices and data collection strategy from primary (elite interviews) and secondary sources. It also includes a discussion on the data analysis. Chapter Four discusses the development of the automotive industry in Malaysia. First, it provides an overview of the automotive industry in the country and then it describes the historical perspectives of the industry. The explanation includes the significance of the automotive industry as part of the country's heavy industrialisation programme. Subsequently, the chapter discusses the birth of the national car project that gave rise to industrial nationalism. Other policy and programmes associated with the nationalist economic programme are also discussed.

Chapter Five discusses trade liberalisation and Malaysia's national automotive policy. This chapter provides explanations from the findings about how the government responds to trade liberalisation. Though the national automotive policy is to liberalise the domestic automotive market, various policy terms are intended to protect the local car companies and vendors. Chapter Six presents an assessment of the national car project, Proton. This chapter focuses on policy that makes Proton a full-fledged national carmaker. An analysis of the politics surrounding Proton is also presented, based on the qualitative data gathered in the study. Chapter Seven delves into the politics of the policy-making process with regards to the national automotive policy. This chapter analyses the empirical findings of the politics of policy process in Malaysia. Analysis of the empirical investigation will highlight institutional arrangements formed by policy actors to define and defend policy terms to protect domestic automotive sectors. This reveals not just the strength and constraint factors of elite policy actors but also how the dynamic of politics evolves around Malaysian policy-making institutions. Analysis of the reciprocal relationship between government and private sectors and politico-bureaucratic ties are also presented in this chapter. Finally, Chapter Eight is the final chapter of the thesis. It provides an overall discussion of the topic based on the data analysis. Contribution of the study is also presented in this chapter.

Chapter 2

Theoretical Framework

2.0 Introduction

Explaining the course of economic development and determining factors that might affect it has continuously been an important topic of political economy. A focus on institutions has been central to the explanation of economic growth and the policies associated with it in all forms of capitalism. Central to an institutional framework is that institutions shape, facilitate, constrain and guide interaction between economic actors to determine developmental outcome or its decline (North, 1991). Institutional set ups are not homogenous, every country's institutions differ significantly and all are nationally bounded because they are constructed by nationally specific formal rules (law and policy) and informal rules (norms, values and embedded conventions). How economic actors interact, resolve problems and form collective interests is affected by the dominant cultures and regulative institutions (Scott, 2008).

The variation of institutional design across countries means that industrial development and configuration of the policy could not merely be based on the neo-classical perspectives (Chang, 1999; 1994; Chang and Evan, 2005). Instead there is a need to take into account the institutional context of a developing country, where interaction of actors is subject to wider influences such as history, political process, power relations, norms and values (Steinmo, 2008; Campbell, 1998). These factors affect the organisation of economic actors, ideas and agenda development, and aggregated economic preferences in the policy-making institutions (Whitely, 2003). Variations of institutional design influence choices and strategy of industrial policy, and therefore industrial development differs significantly in each country.

To explain the politics of industrial policy formation in Malaysia, this research utilises new institutional theory to build on theoretical lenses to explore policy-making institutions. Most analysis on the political economy of industrial policy formation uses either rational choice models, institutional economics or collective actions approaches (Williamson, 2000; Ostrum, 1990; Bates et al., 1998). The abovementioned approaches leverage on an economics paradigm (Jenniver, 2009), in which the main concern of the analysis is centred on allocation of scarce resources and is efficiency oriented (Krippner, 2001). This includes a focus on 'maximising utility' and is premised on the agency theory, whereby actors have a fixed set of preferences and behave entirely to attain their preferences that presume extensive calculation (Keohane and Martin, 1994; Shepsel and Weingast, 1987 cited in Hall and Taylor, 1996). Rational choice institutionalism has its own merits and has contributed insights to the political economy of economic policy analysis. However, such an approach does not capture the whole spectrum of political economy and the politics of industrial policy (Campbell, 1997a), particularly in a developing country. This rational choice approach falls short in taking history, political process, power relations and normative aspects as main concerns in policy decisions.

Instead preferences of economic policy are subject to the domestic institutional context in which actors are embedded (Haggard, 2004), and politics cannot be separated from the policy-making process (Doner, 1992). For this reason, this research will use new institutional theory by leveraging historical and sociological paradigms. Historical institutionalism provides historical context and reveals power relations that structure the interaction between principle actors in policy making (Thelen, 1999; Steinmo, 2008). Sociological perspectives are concerned with dominant normative and cognitive dimensions that influence actors' behaviour in a particular institutional context (Dimaggio, 1998; Scott, 2008). Using the role of institutions able to explain how politicians, bureaucrats and 'selected' industrial groups have the capacity to mobilise, prioritise and coordinate scarce resources in policy making institutions thus influences industrial policy formations.

A developmental state approach will also be incorporated to help frame the theoretical lenses. This approach, associated with developing countries, is used to pursue long-term industrial development. From this approach the state is able to impose its will to direct economic development projects. Developmental state paradigm posits that the state consists of a set of institutions that structures interactions between society and political institutions. Further, the state has the capacity to formulate and impose policy with less intervention from societal groups, because there is a weak link between state-society relations (Woo, 1999). Such uneven the power relations are broadly influenced by the institutions (which has its roots in historical events, domestic political factors and embedded conventions). The developmental state approach is usually associated with Northeast and Southeast Asia industrialisation. The central question in the developmental state approach is that if Southeast Asia adopted such an approach, why are they unable to produce stellar industrial development like their counterpart? Most scholars, such as Haggard (1990; 2004), Doner (1992; 1991b), Low (2004), Abbott (2004), Jomo (2004) and Chang (1999) argue that the direction of industrial policy formations is subject to the nationally-bounded institutions.

Industrial policy lies in the institutions, which structure the organisation of economic actors and their interactions. Analysis of the developmental state approach could not ignore the role of institutions, which constitute the 'rules of the game' in industrial policy formation (Haggard, 2004; Weiss, 1995; Chang, 2003). As Chang (2003) argues, institutions are a necessary condition for effective industrial policy in a developmental states approach. That is, success or lack of success depends on the country's institutions. Pertinent to this approach is that the role of institutions structured by executive dominance and bureaucratic unity have the capacity to devise policy instruments and strategic use of resources. The state actors (political, executive and bureaucracy) and 'selected' business groups play strategic roles to direct economic outcome in the policy-making institutions. Nevertheless, variations of the domestic institutional context can affect actors' interactions, which in turn influences industrial policy strategy and preferences, as well as the way the state is '*developmental.*'

This chapter will also discuss institutional arrangements as part of framing the theoretical lenses in policy-making institutions. Institutional arrangements can explain the relationships between actors to coordinate, bargain, resolve conflicts and determine economic preferences (Hollingworth, 2000), which can influence policy-making institutions. Institutional arrangements are seen as a form of deliberation by principle actors taking place to influence the allocation of resources, strategy and feasibility of industrial policy. It also creates 'order' to attain mutual gains and reduce conflict. The mode of coordinating and the deliberation process are affected by the dominant regulative and normative dimensions of the institutional context. This can influence the mode of institutional arrangements either through formal and informal rules. Power relations in the institutional arrangements can also influence whose ideas and preferences will be incorporated in the industrial policy; hence this can help explain the politics by principle of economic actors, i.e. politician, bureaucrat and selected business groups to coordinate economic development in a developmental state approach.

The next section of this paper will integrate the theoretical lenses based on new institutionalism and a developmental state approach to build a framework to study the politics of Malaysian industrial policy-making institutions. As a developmentalist state, the existing institutional structures underpin the role of the political elite, bureaucracy and 'selected' business groups in determining policy preferences (Ritchie, 2009; Nelson, 2012). Thus, policy-making institutions are non-pluralistic. There are uneven power relations between state and society; hence the political elite can transfer resources for industrial development with less opposition from organised groups peak organisation (Khoo, 2012; Tan, 2009). Formation of industrial groups at the outset is linked to political process, so mobilisation of resources is linked to close connection between business groups and elites (Haggard, 2004; Ritchie, 2005). Industrial policy is somehow obscured; it is likely to have political objectives that may subordinate overall economic goals (Tan, 2008). In short, a 'triangular of arrangement' between the state elites (politicians and bureaucrats) and industrial groups (who are linked to state elites) may construct the rules of the game that eventually influence policy formation.

The integrated framework to study the politics in Malaysia's industrial policy-making institutions can explain what the institutional arrangements in policy-making institutions are, and how political and economic actors mobilise, coordinate and prioritise economic resources. Considering the strategic role of the state elite (politicians and bureaucrats) and selected business groups in policy-making institutions, the elite can mobilise scarce resources swiftly and adjust industrial policy (Meerman, 2008). However, the elite can be inflexible in policy changes, given that its political objectives intertwine with the domestic enterprise interests who are linked to political elites (Khanna and Palepu, 2010). It is the interest of this research to understand the politics of policy-making institutions.

2.1 Neo-Institutionalism

The economic success of East Asia and Southeast Asia has turned various scholars' attention to understanding the political economy of the latecomer industrialising countries. Most of the literatures highlights that the economic development of these countries has challenged the position of neo-classical accounts of industrial development and growth. Many political economists, including Wade (1990), Amsden (2001), Evan (1995), Chang (1999), Low (2004), Jomo (2004), Abbott (2004) and Henderson (1993), have claimed that the political economy of the industrial development in this region relies on strategic roles of the state actors in configuring and implementing industrial policy to attain development trajectory. The key that enables state actors to develop strategic interactions and selective policy arrangements lies in the role of institutions (Weiss, 1995; Haggard and Webb, 1993; Tipton, 2009; Doner, 1991a). The institutional setting of a newly industrialising country makes it possible to strategically coordinate industrial policy, market entry, and allocation of resources to promote industrial development.

Institutions are important as a theoretical lens to assess what shapes, facilitates and constrains interactions between economic agents to determine developmental outcome. Based on the new institutionalism perspective, the analysis of institutions does not merely focus on the formal rules (policy, constitutions and law), but also includes the broader informal institutional constraints (norms, values and embedded conventions) (Lowndes, 2010). Institutions are the metarules that include the basic norms, conventions, values and rules of the society that govern economic actors within a specific institutional context (Hollingworth, 2000, p.62). Various scholars have identified different strains of neo-institutional approaches (Peter, 2005; Hall, 2010; Lowndes, 2010; Hall and Taylor, 1996). All of these approaches emphasise the significance of institutions in determining social, economic and political outcomes. In their widely cited work on different strains of new institutionalism, Hall and Taylor (1996) have identified three important paradigms of new institutionalism: historical institutionalism, sociological institutionalism and rational choice institutionalism. They argue that each of these institutionalism paradigms agree that 'institutions matter.' However, each paradigm has different analytical approaches to 'explain the role that institutions play in determining political outcomes' (ibid, p.936), which defines a country's policy regimes.

It is important to examine how each of these strains of institutionalism defines institutions, because different analytical approaches view how institutions affect the behaviour of the actors differently. Historical institutionalism (HI) defines institutions as formal or informal procedures, routines, norms, standard operating procedures and conventions embedded in the organisational structures of the polity or political economy (Hall and Taylor, 1996 p.938). It is a 'structural frame that constructs the relationship between actors in various units of polity and the economy' (Hall, 1986, p.19). The important assumption here is that the rationality of actors is institutionally bounded (Braathen, 1996). Political actors are not so much all-knowing rational maximisers as they are rule-following satisfiers (March and Olsen, 1989 cited in Braathen, 1996, p.219). Actors' strategic choices are confined because choices are institutionally defined, and the pursuit of these choices may not always be as significant as actors think. In addition, their preferences are politically and socially constructed (Braathen, 1996).

From the historical perspective, the state is conceptualised as a complex set of institutions that interacts between the social and political institutions (Jenniver, 2009, p.32; Braathen, 1996). Institutionalist scholars within this paradigm take history seriously, as Steinmo (2008) points out that 'history matters' because political decisions on certain policy take place within historical contexts, which has direct consequences on the institutional setting. The history of institutional design highlights the 'whole range of state and societal institutions that structure power relations between political actors and other actors embedded in the institutional context' (Thelen and Steinmo, 1992, p.2). As a consequence, the institutions determine distribution of power between political actors and other groups. This structure the interaction of political actors and their capacity to define and defend interests. The unintended consequence is that actors embedded in the institutions are subject to asymmetrical power relations (Hall and Taylor, 1996). Configuration of policy preferences and ideas in the political institutions are subject to uneven distribution of power between political elites and other social groups.

Sociological institutionalism (SI) defines institutions as the formal rules, procedures or norms, symbols system, cognitive scripts and moral templates that provide the 'frame of meaning' guiding human actions (Hall and Taylor, 1996 p.947). Scott (2001), who analytically leverages from the sociological viewpoint, refers to institutions as social structures that are composed of regulative, normative and cultural cognitive elements that, together with associated activities and resources, provide stability and meaning to social life (p.48). Therefore, institutions consist of formal written rules and an informal unwritten code of conduct, which underlie the institutions and shape interactions and choices for actions. This paradigm is cultural-sensitive because proponents of this approach see blurred lines between institutions and cultures (Meyer, 2010; DiMaggio, 1998). This brings their emphasis to the normative and cognitive dimension (informal rules) (Hall and Taylor, 1996; Dobbin, 2004). The normative dimension refers to how institutions influence behaviours based on expected norms or shared values and understanding between individual actors. The cognitive dimension is based on the individual actors' responses and interpretation of meaning for action as structured by the institutions (Dimaggio and Powell, 1983). This unwritten convention becomes prescript for particular individuals or specified social positions in interpreting world views. Policy decision is largely dependent upon the interpretation of the individual actors being in line with the societal norms. The institutionalised norms and cognitive understandings facilitate interaction between individual actors on how to respond policy problems.

Given that sociological institutionalism is underpinned by social constructivism, institutions (rules) are structured by what is socially appropriate and accepted by the society within a specific context (logic of appropriateness) (Hall and Taylor, 1996; Scott, 2001; Campbell, 1997a; 1997b), and this includes interaction of the economic actors in responding to policy problems. Institutions influence 'behaviour not simply by specifying what one should do but also by specifying what one can imagine oneself doing in a given context' (Hall, Taylor 1996: p.948). In this sense, 'for any institutional change, actors will initially define and articulate their problems and solutions by utilizing the institutionalized scripts, cues and routines constituted by their cognitive frameworks' (Campbell, 1997a p. 378).

While the historical and sociological are underpinned by inductive reasoning in defining a new institutional approach (Steinmo, 2008; Campbell, 2004), rational choice institutionalism (RCI) draws its analytical tool from economic perspectives (Weingast, 1996). This paradigm posits that institutions provide relevant actors with a fixed set of preferences and they face rule-based constraints that influence their behaviour (Hall and Taylor, 1996). In this approach, individual actors are assumed to be utility maximisers, so in order to attain the predetermined preferences, actors will interact strategically to secure their interests. Rational choice institutionalism views individuals as behaving strategically to canvass all possible options to select maximum benefits. Individual actors are rational actors who calculate the costs and benefits in choices they face (especially the transaction cost for any action they choose) (Steinmo, 2008, p.126). Since interaction is based on strategic calculation by actors, it is suggested that institutions structure the interactions with a range of alternatives on choice of agenda, access to information and enforcement mechanisms to reduce uncertainty about the behaviour of others and enable gain for exchange, thus leading to better policy outcome (Ostrum, 1999). Institutions provide the framework for actors to make choices, directing expectations and offering sanctions or incentives. The theoretical orientation of institutions is the result of an individual rational cost-benefit equation, as it is perceived to reduce transaction costs (Williamson, 2000; Hall and Taylor, 1996). Proponents of this approach tend to analyse policy problems from collective action problems, when individuals acting to secure policy interests are likely to produce an outcome that is collectively suboptimal (Vanhercke, 2006, p.11). Another approach, like game theory, assesses individual behaviour (with a quantitative approach) in responding to problems based on predefined rules and options (Hall and Taylor, 1996).

Rational choice institutionalism has its roots in economic theory and behaviouralism, which both use deductive reasoning to determine how institutions structure the behaviour of economic actors (Hall and Taylor, 1996; Lowndes, 2010). Rational choice institutionalism has been instrumental in highlighting policy decision from collective action problems. However, examining 'how actors behave in the way they do' based on predefined rules (particularly in collective actions problems) or responding to incentive is not sufficient enough to understand the real motivation behind actors' behaviour. There is a broader dimension on how and why certain actors respond to an environment that cannot merely be viewed from cost-benefit analysis (Sanders, 2010). Rational choice institutionalism does not display these nuances, and it misses other dimensions of the role of institutions have in structuring actors' interactions and behaviour (Lowndes, 2010). This is because institutions are bound to historical context and normative regulations, which indeed influence how actors choose certain courses of action and how they define policy problems.

The rational choice approach rests on a simplistic view of human motivation (Campbell, 2004; Cook and Levi, 1990). Assuming the interaction of economic actors as utility maximisers views institutions as ahistorical and less sensitive to the normative regulations of the institutions (Steinmo, 2008). This likely downplays the broader dimension of rules (normative, embedded conventions, values) of the institutional context, as Levi (1997) points out that the rationalist is 'almost always willing to sacrifice nuance for generalisability and detail logic' (p.21). This does not delve into the political phenomenon of the policy processes, as Green and Shapiro (1994) claim, though rational choice has produced elegant theory but has generated little to explain real observed events that shape, facilitate and constrain economic actors' interactions in determining policy outcome.

Therefore, this research will view the role of institutions from the theoretical lenses of historical and sociological institutionalism. Thelen (1999) reveals that there is some important borrowing and cross-fertilisation between these two strains of institutionalism. Braathen (1996) suggests that by linking the historical and sociological, on one hand, the aim is to understand that actors' behaviour is institutionally bounded, and their preferences are politically and socially constructed. On the other hand, the aim is to assess the normative and cognitive dimension. Incorporating both, it 'holds the centre' for institutional analysis and a more expansive view of the role of institutions; therefore, it goes beyond strategic context to a set of shared understanding that affects the way problems are perceived and solutions are sought (p.371). The two approaches provide a 'context-specific' approach to a country's institutional design, including the regulative and normative institutions that facilitate economic actors' interactions in the politics of economic policy making. Paying close attention to the institutional context, as Thelen and Steinmo (1992) argue, 'provide[s] strong focus on how institutional structures politics yielded compelling accounts of policy continuities within countries over time and different policy outcome across countries'.

2.1.1 *The role of institutions*

Institutions are commonly referred as the 'rules of the game' in the society; it is human to devise constraints that shape human interactions (North, 1991). Institutions are seen as rules that structure interaction between actors, affecting social, political and economic outcomes. The role of institutions focuses its interest on the interaction of polities (the political institutions) and politics (the political process) to explain policies (outcome) (Jenniver, 2009, p.32). Pertinent to this is that different countries have different institutional set-ups, because formation of institutions broadly depends on the society' culture, habit and history. Historical institutionalism suggests that institutions are linked to the path dependence, a collective decision in the past by a society on how things are done (Hall, 2001). Sewell (1996) points out that 'what has happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later time' (p.262), which creates a historical legacy of rules, capacities and norms. Such legacy is an 'intergenerational transfer from past to present' (Beisingger and Young, 2002), and institutions transmit the norms, values, capacities and routines acquired in previous times (Jenniver, 2009, p.38).

Institutions are linked to certain legacies, as Pierson (1994) argues, 'past line of policy condition subsequent policy by encouraging societal forces to organised along the same line than the others' (cited in Hall and Taylor, 1996; p.941). The established legacy has a powerful effect on institutions for a long period of time, which structures individual behaviours, because once rules, norms and values are institutionalised, actors adapt their strategies in a way that reflects the institutions and reinforces the logic of systems across actors embedded in the institutions (Thelen, 1999). This can potentially constrain possibilities for change in policy, as Thelen claims that institutions are 'isomorphic' (compatible with resembling or renewing with similar logic), because political elites interpret based on the institutions they are embedded in, so even when the actors attempt to redesign institutions they are constrained in what they can conceive due to these embedded and cultural constraints (p. 386). North (1991) terms the situation as the 'locked in' effect of the institutions, and changes to institutions are often limited, especially as powerful actors that benefit from the institutional setting can constrain institutional change. This effect enables institutions to persist over time.

However, this does not mean institutional change does not take place. Institutional analysis often posits that institutional change is possible through 'critical junctures', moments when substantial institutional change can take place, thereby creating a new path from the historical development (Gourevitch, 1986, Thelen, 1992). This happens when institutional arrangements take place and depends on collective actions attained by various actor groups in a society to create incentive for change (Hodgson, 2006). Though institutions are often seen as having long periods of stability, changes can come from a 'shock' such as conflict or crisis, exogenous pressure (liberalisation) or the political process in policy field (Boettke et al,, 2008). A 'shock' can lead to revolutionary change especially when there is a breakdown of institutions (Krasner, 1988). However, Thelen (2002) argues that not all environmental shifts are destabilising and not all shocks cause institutional breakdown. In fact, institutional change can be evolutionary because the need to change is always a question between beneficiaries and non-beneficiaries. The interplay of society and political power groups has decisive effects on institutional change to be evolutionary (Thelen, 1999). Therefore, new rules or governance can be formally introduced, but may not necessarily undermine informal institutions and powerful actors' interests in old institutions, so such change can be incremental.

Path dependence bears on institutional constraint for actors' interactions. Thelen (1999) argues that path dependence can lead to a 'distributional effect,' referring to the role of power and asymmetrical relations of power plays between groups. Since political balance of power in an institutional context structures interaction between political actors and other groups, Thelen points out that 'institutions are not neutral coordinating mechanisms but in fact reflect, and also reproduce and magnify, particular patterns of power distribution in politics' (p.394). The distribution of power in political institutions makes a difference in policy outcome (March and Olsen, 1984), because institutions structure some groups (for example elites or interest groups) to have access to the decision-making process. Even though policy decision is open for competition between numerous groups, institutional constraints can circumscribe political participations and equality, hence can lead to unequal access to the decision-making process. Therefore, political institutions structure the kinds of interest most likely to be represented in the policy process (Steinmo, 1993).

Since institutions structure the balance of power between groups and mediate political struggles, asymmetrical power relations provide certain groups of elites with an advantage over others. Elites here are individuals or groups (usually very few) who have power to shape main political and economic outcomes. Drawing on Mills' (1958) definition, elites are at the top level of those who are in command of the major institutional hierarchies of modern society—the executive branch of the national government, large business corporations and the military establishment. These power elites (for example political leaders or heads of business groups) share similar class status and status origin, and, having values consensus, their personal, social (informal) and formal interactions with each other can maintain the status quo or change the 'rules of the game' without affecting their interests (Evans, 1995). Political arrangements made by the elites can facilitate and empower the groups to actively disarticulate and marginalize others.

Leveraging from the two views of historical and sociological institutionalism, an important assumption about the role of institutions is that political actors are not utility maximisers (abiding by rules to increase individual gain or maximise interest), they are utility 'satificers' (Braathen, 1996). This suggests that actors are norm-abiding rule followers, while at the same time they attempt to maximise their interests within the institutional context, so how one behaves depends on the individual, the context, time and rules. In other words, an actor will respond to what is appropriate behaviour within the broader cultural environment (Hall and Taylors 1996, p.949). Sociologists like Dimaggio and Powell (1991) refer to 'what is appropriate,' meaning institutions govern the everyday social norms and interactions because institutions are seen as socially and culturally constituted. In this sense, actors—institutions, in particular—seek to define and express a certain identity in socially appropriate ways (Hall and Taylor, 1996 p.949). March and Olsen (1989) suggest that what is appropriate is also how political institutions define and interpret the world view, and respond to a particular situation based on the institutionalised norms, values and capacity. As such, actors behave strategically within the institutional context. As Steinmo (2008) (a proponent of historical institutionalism) argues, 'humans are not simple rule followers', while the role of institutions structures norms and rules, political actors operating in an institution will act strategically based on existing norms, values and rules (what is appropriate) to attain their interests, with a purpose of political stability (Jenniver, 2009). This has implications on spreading policy ideas and configuring preferences and interests, and hence influences policy outcome (Campbell, 1998).

The role of institutions defining rules and norms has implications on shaping political and economic interest or preferences (Campbell and Pedersen, 2001). Historical institutionalist scholars define interest as 'the real, material interest of the principle actors whether conceived as individual or as groups' (Hall, 1997, p.176). Immergut (1998) refers to interest or preferences as artefacts of institutions; therefore, institutions determine interest and motivations by shaping ways of interaction, opportunity structures and objectives of political actors (Campbell, 1997a, p.22). The role of institutions restricts certain sets of ideas which political elites find acceptable, and formal institutions mediate the degree to which elites transport different ideas into the policy-making domain for consideration (Campbell, 1998, p.378). This suggests that to seek political solutions or resolve conflicts, political elites tend to favour their material interests (or groups associated with them) over other disadvantaged groups (Hall, 1997, p.937). An interpretation of interest or preference can lead to different outcomes in policy direction, since mediating policy preferences is a political process among rival groups, but conflict of interest is mediated by institutions. The balance of power between groups structures the capacity of them to channel interest in the policy making arenas. As Hall and Taylor (1996) and Hall (1986) argue, institutions are a principle factor structuring collective behaviour and shaping power relations among actors that privilege some and disadvantage others. This is the reason why some ideas or preferences are considered, why certain ideas or interest are adopted, and why others are not. It is also why certain groups are able to advance their policy ideas but others are not (Campbell, 1998; Thelen, 1999).

The role of institutions shape interpretations for possible courses of action by political elites. As Scott (2001) aptly frames it the interpretation of interest or definition of problems is largely based on actors' subjective interpretation of their objective situations. This includes norms, routines and values that can constitute an actor's interpretation of policy solutions. Most rational choice theorists have downplayed this dimension, as they assume actors devise policy solutions to a problem to adopt practices that can increase organizational efficiency or otherwise reduce costs relative to benefits (Campbell, 2004, p.18). Such an assumption is less sensitive to actors' norms and values when they operate in a particular institutional context. Hattam (1993) argues that actors' interpretation of interest or solution to a problem does not exist in t a vacuum, as the historical constraints and normative and cognitive dimension constitute an interpretive frame and meaning that enable actors to interpret the world from certain point of views. This is the reason why different actors may interpret similar situations differently. For instance, political actors may differ in interpreting industrial development or industrial policy approaches to attain economic development.

The interpretive frame of actors is deemed central to how the elite 'package' formation of policy interest to convince the general public that certain policy proposals constitute plausible and acceptable solutions to problems within the institutional context (Campbell, 1997b; 1998). Since institutions enable interests to be interpreted by political elites according to regulative and normative institutions, they are subject to constant manipulations by political actors to respond to specific situations and circumstances (Lewellen, 2003). Schattshneider (1957) points out that political organisation is the 'mobilisation of bias', where political actors have bias in favour of exploiting some kinds of interests while suppressing others. The role of institutions enables elites to interpret policy interest to prevent change in policy outcome or block potential policy that is against their interest. In this context, even though change takes place, it is subject to what Mohaney and Thelen (2010) refer to as '*layering'*: the creation of new rules together with old ones where change occurs not through the displacement of old rules, but rather through the addition of new ones on top of old ones. It can also occur through '*conversion'*, where rules remain formally the same but become interpreted and enacted differently (p.17). This suggests that though there are well-established rules, the interpretation of them can act as a constraint on how a possible course of action is defined or framed. A leadership role is significant to define preferences based on the normative and cognitive dimension of the institutional setting.

Formal rules (codified rules) and informal institutions (norms, values) construct the role of institutions. Particularly for sociologists, the cultural dimension that constitutes normative and cognitive dimensions has a profound impact on shaping actors' interactions, preferences and objectives. The cultural dimension can be viewed as informal institutions that institutionalised norms and embedded conventions (Hosftede, 1983). The informal institutions embody customs, tradition and code of conduct structures of behaviour, interaction and preferences. Following Scott (2008), the normative dimension (the unwritten code of conduct) institutionalised certain norms that form a binding expectation for actors' behaviour. Similarly, March and Olsen (1989) argue that institutionalised norms like standard operating procedure reflect the routine way in which people do what they are supposed to do (p.21). Scott also refers to the normative dimension as logic of appropriateness (drawing from Campbell's work), which usually refers to what is the appropriate behaviour one *should* do in accordance to the cultural context. In this sense, the informal institutions set a powerful course of social interaction in a given institutional context.

Informal institutions can act as sanctioning in social interaction because they institutionalised a standard of expected behaviour, so violated norms may lead to social disapproval or punishment as a way to discontinue the interactions. In contrast, conformity to norms leads to social approval and rewards are expected (North, 1990). In relation to social interaction, political scientists like Helmke and Levitsky (2004) refer to 'informal institutions as socially shared rules, non-codified, communicated and enforced outside of officially sanctioned channels' (p.727). They view informal institutions as important avenues for political actors to influence the political process. O'Donnell (1996) views informal rules as 'actual rules being followed' if the social interaction between actors in a particular institution includes rewards, for example, in a patron-client network. These can be actual rules that structure interaction to advance individual interests, because informal mechanisms govern network-controlled exchanges and norms become the 'rules of the games' (Collin, 2002, p.23). The informal dimension can have a critical part to play in maintaining, preventing or undermining consensus and adherence to formal rules (Leftwich, 2010, p.7). It is also a powerful form of interaction in discussion or cooperation between economic actors and those who influence policy arrangement.

From the above discussion it is obvious that 'institutions matter' as they shape, facilitate and constrain actors' interactions. An important consideration of institutionalism is that there is no homogenous set of institutions because different societies have distinctive sets of rules, norms, values and embedded conventions. This manifests different institutional designs across countries, so the institutional design of developed countries could not be compared to that of developing countries. Given the limitation of rational choice institutionalism, this research will leverage neo-institutionalism from historical and sociological lenses. Using both institutionalism paradigms, it emphasizes historical specificities, the political process and the social context that constitutes the country's institutional design that have implications on the policy making process. This framework also provides broader understanding of the actors' interactions and the wider institutional constraints.

2.2 Developmental State and the Role of Institutions

The developmental state approach is commonly referred to regarding the late industrializing countries, particularly Northeast Asia (Japan, South Korea and Taiwan) and some Southeast Asia countries. Following the success of the Asian economy, industrial growth is seen as a country getting the 'right fundamental policy,' such as market-friendly economic policies to promote industrial development. However, the industrial accumulation of a late industrialising country could not merely be assessed from neo-classical perspectives (macroeconomic stability, enforcement of rules, high rate of physical and human capital investment, clear property rights), however the state plays a strategic role to facilitate industrial development growth. This again challenges the description of neo-classical accounts on economic development.

The industrial development of such states highlights the strategic role of the state in the market. The state-market relationship through industrial policy is crucial to promote a development trajectory in selective industries. The key enabler for a reciprocal relationship between the state and market lies in the role of the institutions. Most institutional scholars argue that the state is the central place for political competition and mobilisation of resources, but the state consists of a set of institutions that structures interactions between society and political institutions (Whitley, 2003, p4; Haggard, 1998; Kang, 2002; Amsden, 2001). As Moon and Prasad (1994) argue, the developmental state has emerged as an innovative theoretical construct to elucidate the causal nexus between institutions and economic performance, because central to the developmental state paradigm is that its institutions are structured by executive dominance and bureaucratic unity that have the capacity to devise policy instruments and strategic use of resources (p.361). The political institutions have the ability to insulate economic decision making from other contending economic actors' interest (Johnson, 1982; Deyo, 1987; Amsden, 2001; Wade, 1990). The institutional design of developmental states enable principle economic actors (political, bureaucratic elites and selective producers) to mobilise resources and configure industrial preferences. As Wade (1990) points out, arrangements taking place between economic actors is crucial to coordinate and implement industrial policy. The elite policy makers are able to devise market entry, while configuring preferential access to state resources for selective producers to compete in the market. The reciprocity of the government and 'selective producers' (either through formal interaction or beyond arms' length relationship) in which the institutions enable these interactions has been important for economic development.

The developmental state concept is referred to as the state seeks to attain economic development through industrialisation by improving targeted sectors to make them competitive at the international level (Johnson, 1999). The overarching intention is to promote long-term entrepreneurial perspectives among the industrial elite comprising key business groups and resist growth-compromising demands from special interest groups (Johnson 1982; Evans, 1995 cited in Low, 2001 p. 413). Here it features the strategic role of the state elites (politicians, bureaucracy) and 'selected' industrial groups to devise economic development. Johnson (1982) describes the developmental state approach as ‘a shorthand for seamless web of political, bureaucratic and moneyed influences that structures economic life in capitalist Northeast Asia’. He further points out that such an approach is ‘each side uses the others in a mutually beneficial relationship to achieve developmental goals and enterprise viability’ (p.60). Onis (1991; p.112) suggests that the developmental state approach emphasises the state’s strategic roles in facilitating domestic industrial groups in the market while harnessing them to national economic development. The approach does not downplay the role of market institutions in the process of modernising the national economy. However, the state devises policy instruments embedded with national interest to guide the market. The state ‘provides directional thrust to the operation of the market mechanism, and the market is guided by long term national rationality of investment formulated by the state’s institutions’ (Ibid, p.110). The role of institutions in such states enable the state elites and selective producers to deliberate policy, and thus can alter market incentives while protecting vested interests and creating obscurity (Low, 2001, p.413).

While the above definition shows the state directing the economic development project, one important feature of the developmental state is linked to the ‘state capacity’. The capacity is influenced by the institutional setting (path dependence) of that state which in turn structures the power relations between state and society. This structure the principle strength of state elites (politicians and bureaucracy) and other economic actors’ links to them. In his seminal work *Governing the Market*, Wade (1990) points out that ‘the position of the state in relation to its society varies along a continuum from decentralized to constrained by social groups’. Analysing the developmental state approach, he makes the distinction between the ‘soft’ and ‘hard’ state. ‘Soft’ state refers to a ‘state that does little more than register the demands of social groups or at most resists private demands’ (ibid, p.337). The state has the ‘capacity to produce effects in the economy, but lacks the capacity to control the direction of the effect in line with intentions’ (ibid, p.337). Implementation of economic policy can be easily ‘hijacked’ by private or organised groups that affect their interest. ‘Hard’ state refers to Northeast Asia, in which the states able to resist private demands and actively shape the economy and society. They are able to exert more control over the direction of the effect of their interventions. Wade (1990) suggests that conditions for hard states to emerge are based on the Migdal analysis of hard states. Drawing from the experience of South Korea and Taiwan, Wade outlines main features of the hard state: (i) ‘Massive social dislocation, which weakened the existing pattern of social control, including the Korean War and Taiwan’s retreat from the mainland, which changed the social relations in the state'; (ii) 'the existence of social groupings independent of existing bases of social control'[7]; and (iii) 'skilful leaders whose ideology favours a strong state' (p.337).

Such a 'hard' state approach shows that an institution's setting had an effect on structuring the power relations concentrated in certain elites (political, bureaucracy and selected industrial groups), and this enabled the state to configure policy based on the constellation of elite interests. As a consequence, the national institutional design enables the elites to have control over key institutions to exercise their autonomy to construct economic rules and policy formation (Leftwich, 2000). Elites (political and bureaucracy) are able to exercise their power in the states' institutions to mobilise society and material resources for state action. Coherent industrial policy can be implemented without being compromised by other social groups. This is due to weak societal control over the state resources. Weak societal control here refers to business class, landlord and organised groups that have a lesser ability to subvert or exercise influence over the government institutions, and in turn can undermine the state capacity to pursue developmental policy (Lauridsen, 1995). The institutional design of the state also structures the ability of the elite to exercise control over formal and informal institutions' arrangements to sanction or reward groups in the society. Hence, the state elites can mobilise political and economic interest for development purposes and offer viable strategies of survival to the society (Migdal, 1988). This increases the state's capacity in provision of distribution of economic resources and also constructs rules of the game for the people in society in order to attain developmental outcomes.

The strategic role of the state intervening in the market for rapid industrial development becomes an overriding consideration in the developmental state (Onis, 1999). Scholars like Abbott (2004), Low (2004), Johnson (1982), Woo-Cumming (1999) and Henderson (1993) who observe the capitalist development of the developmental state suggest that the political economy of such states is described as *plan-rational*. In such economies, the state itself leads the industrialization drive, taking on developmental functions (Johnson, 1982, p.19). Given the state capacity, the state is able to set substantive social and economic goals. The government will give priority to the structure of domestic industry and promote the structure that enhances the nation's international competitiveness; hence this implies a strategic or goal-oriented approach (ibid, p.19), such as short-term or long-term industrial policy. Though the state plays strategic roles, the economy remains largely in the hands of private corporations, which exposes it to a market discipline environment (Abbott, 2003 p. 27).

[7] For example the fleeing of Kuomintang leadership was displaced from the native Taiwanese land-owing class they were able to undertake a comprehensive land reform that broke the latter's political power

Though the state ensures rules are adhered to in the market economy, the institutional design of the developmental state structures an interwoven relationship between state and market. Therefore, the state would intervene where necessary in order to achieve national goals, including going beyond arm's length relationships to facilitate private enterprises (ibid).

The developmentalist state approach is able to structure its market entry and direct private companies' activities in selected industries. Since the state is envisioned to industrialise the country, the national institutions enable the government to shape the market to support entry for new industries and encourage investment in a particular sector (Whitely, 1999). Koo and Kim (1992) argue that the existing state capacity of the developmental state provides institutional strength and the ability to exercise a large measure of control over the behaviour of domestic and foreign capital. Market entry for foreign direct investment is structured into certain industries that can build links with domestic industry (most of the Southeast Asian countries are unable to emulate this because the country's industrialisation depends on foreign direct investment). In the developmentalist state approach the state is also likely to be *selective*, meaning that the state tends to create progressively shifting competitive advantage instead of just adapting to existing comparative advantage (Lauridsen, 1995, p.27). One example is the transformation from an agricultural based to industrial based economy, or effective industrial upgrading (from mid-tier function to innovative activities) (Ibid, p.27). When it shifts to certain industrial sectors, the government initiates most major investment for the private sector, and as such the state would ensure private sectors have access to state resources in order to grow in the marketplace. Strategically shifting from one sector to another may give rise to a plausible tension regarding resources allocation. However, the state elites are able to resolve conflict (for instance between different segments of capital), then allocate resources to the most productive groups. Then, state elites are able to construct economic rules that advance long-term sectional interests, technological character and promote growth (Pempel, 1999).

In this sense, the developmental process is based on close connections between state and 'selected' industrial groups, and is a conjoining effort to modernise the domestic economy (Woo-Cumming, 1999). In her analysis, Weiss (1995) coins the term '*governed interdependence'*, which is a coordination based on collaboration between government and private sectors. Industrial policy from such coordination is based on regular and extensive consultation between government and private sectors. Weiss points out that 'government-business cooperation in developmental states is able to reduce private sector risks' by (i) 'raising capital', (ii) 'developing new products and technologies', (iii) 'finding new markets', and (iv) 'training skilled engineers and workers'. 'A significant proportion of the costs of upgrading technology, new product development, industrial training and market expansion, among others, are shared by, or embedded in, a thick network of public-private institutions' (p. 594).

Deliberations of economic strategy is devised by either formal or informal ways between government and private sectors. To ensure economic development is in line with the national interest, 'numerous unusual institutional arrangements' take place to facilitate the growth of the private sector with preferential access to state resources (Johnson, 1982, p.312; Abbott, 2004). Close ties between the state elites and industrial groups enable these actors to configure policy arrangements through deliberation to resolve conflict, determine preferences and adjust economic policy outcome. The state elites play strategic roles in the deliberation process to advance economic preferences (Onis, 1999). Given the state capacity, state elites can mobilise state resources swiftly, instead of relying on the market mechanism (Wade, 1990). The ongoing consultation enables the state to prioritise research and development, financial support, technological upgrading and training and development. The state elites are able mobilise resources from unproductive industrial groups to more productive ones, while imposing discipline through export performance, attaining greater economies of scale and improve the learning curve (playing industrial catch up) (Jomo, 2004, p.59).

The close connection between government and industrial groups in the developmental state approach allows the state to produce coherent industrial policy. The ability of the state to shift resources to a particular industrial group reveals that the state has the ability to mobilise resources without being challenged by organised groups (trade union and civil society) or other private interest groups (landowner). Given the institutional environment, developmental states tend to have a weak social class. This affects the organisation of interest groups such as labour unions or civil society groups to form collective actions. Organised group action is limited to underline the policy formation and implementation by the governing elites. However, Wade (1990) points out that the state does not sanction the creation of peak organisation entirely. To support policy formation, the state nurtures the formation of organised groups to advocate for the interests of the industrial groups linked to state elites. The organised groups are involved in the policy making process, but the extent to which these organised groups can have equal bargaining power between the state elites (politician, bureaucrats) and industrial groups remains limited (Onis, 1991). The state elites possess considerable leverage to determine strategic choices in policy institutions. Having less interference from peak organisation or other private interest groups, ruling elites can conveniently set the economic preferences of the state with lesser collective action problems. The policy making domain in the developmental state approach thus features an unequal playing field, because not all economic actors in the society are able to collectively organise to influence policy decisions. As Onis (1991) describes, policy formation in the developmental state is inconsistent with the pluralistic form of democracy, because only small-scale interest groups enjoy broad and unrestricted access to the state resources (p.119).

The institutional environment where the state elites have weak links with societal groups enables the elites to prioritise rapid economic development and rising standard of living as means of providing legitimacy for the ruling elite. Dean's (2000) observation on capitalist developmental states describes this as *developmental legitimacy*, whereby development forms the most important legitimising principle of the state. The legitimacy of the state elites is based on developmental achievement, as Castell (1992) notes that the 'ability to promote and sustain development is understood by the combination of steady high rates of economic growth and structural change in productive systems both domestically and in relationship with the international economy' (cited in Abbott, 2003, p.56). It is when the state elites commit to economic transformation to improve the material needs of the society, so the people are committed to the economic order. This is likely to reduce the formation of collective interests among other groups in order to underline elites' interest in pursuit of economic development. In the economic policy front, the elites are able to prioritise the need for economic development and steer away from unnecessary private interests of groups that can compromise the implementation of economic policy (Abbott, 2004; 2003).

Deans (2000) argues that in developmental states the state ideology is important and can provide powerful tools for ruling elites to achieve specific developmental goals and consensus. Abbott (2003) notes that historical specificities (path dependence), radical change in political institutions and external threats enable the governing elites to mobilise nationalism in economic policy. For example, in Taiwan and South Korea state elites were able to utilise the fear of take-over by their communist rivals to achieve this (ibid, p.29). In the developmental state, the institutions have structured a weak link between state and societal groups relations, so the governing elite can easily use or manipulate nationalism in pursuit of industrial development. Ethno-economic development can also link to nationalist economic projects, especially in developing a country where the ethnic imperative is an important political consideration (Low, 2004; Case, 1994). Skilful political leaders can use symbols of nationalism or ethnic imperatives as an interpretative frame in industrial policy making with the intention to strategically intervene in the market (Abbott, 2004). This enables elites to mobilise resources with less chance of being challenged by specific organised groups. Mobilisation of a nationalistic economic policy can infuse in the nation's institutional setting, thereafter structuring developmental goals for political and economic actors.

The bureaucracy is one of the most important features in the developmental state approach. From neo-Weberian perspectives, Evans (1995) suggests that in a developmental state model, the bureaucracy plays an important role in constructing economic rules, implementing economic policies and exercising control to maintain the rules, ensuring the state's developmental outcome is attainable. The bureaucracy is filled with technocratic elites, staffed by the most able and highly qualified groups in the country. Johnson's analysis on the Japanese developmental state model reveals that technocrats in the Japanese Ministry of International Trade and Industry play crucial roles to devise strategic industrial policy. Similarly, in Taiwan and South Korea the same role is performed by the Central Planning Department and Economic Planning Board to ensure that coherent economic policy is implemented in line with state elites' interests (Amsden, 1991, 2001; Wade, 1990). Wade (1990) points out that 'governing the market requires small numbers of powerful policy making agencies to maintain the priorities expressed in the routine accumulation of particular negotiations and policies in line with the notion of the national interest' (p.195).

Autonomous bureaucracy is central for the economic technocrats in a developmental state to form coherent economic policy, as Wade (1990) argues that the bureaucracy can function based on meritocratic practices because it is protected from other societal groups' interests. Here the political institutions have the capacity to insulate the state bureaucracy. Bureaucratic capacity and autonomy can provide the ability to devise long-term, coherent economic policies with less interference from private interest groups. Onis (1991) argues this, stating that political insulation of the bureaucracy enables technocratic bureaucracy autonomy to shape development strategies and translate national goals into effective policy actions. Evans (1995) indicates that this is parallel to Weberian bureaucracy, because ideally with bureaucratic insulations, the technocrats with specific expert knowledge are able to enforce rules and provide policy mechanisms to facilitate industrial development.

The close ties between state bureaucrats and 'selected' industrial groups enable the elite economic bureaucracy to create coherent development policies and effective implementations. This is what Evans (1995) terms as 'embedded autonomy' in a developmentalist state. 'Embedded autonomy' can be referred to as dense external ties between the elite economic bureaucrats and productive industrial groups in the society. Since the political institutions are able to insulate the state bureaucracy, the economic bureaucrats are able to independently formulate and implement policy while collaborate with the productive groups (Tan, 2009). The autonomous bureaucracy and the institutionalised close relationship between selected business elites and technocratic elites are able to form a dynamic export-oriented regime of industrial accumulations (Johnson, 1982). As industrial development requires close connections to private capital, such connections must be with 'selected' industrial groups, enabling state elites to incorporate these industrial groups into state economic projects. This embedded autonomy is also reflected in concrete social ties that enable state elites and industrial groups to continuously negotiate policy interests and resolve conflict, and eventually influences policy objectives.

State actors and 'selected enterprises' able to do this due to the unlevel playing field environment, where the institutional structures constrain the interactions of organised private interest groups that can potentially 'hijack' or undermine policy directions at state levels (Gainsborough, 2009). Although developmentalist scholars have highlighted the crucial role of autonomous bureaucracy in industrial development, the degree of autonomy enjoyed by the bureaucracy in a developmental state is widely debated (Routley, 2012). Haggard (2004), Randall (2007), Moon and Prasaad (1994), and Ramseyer and Rosenbluth (1993) argue that even though developmental states rely upon the 'rational' technocratic bureaucracy to plan and implement coherent economic policy, their actions remain influenced by political elites and industrial group interests because the mission and identified goals of bureaucrats are derived from the position of the governing elites (Onis, 1991). The broad policy interests still reflect upon the elite class' interests (Routley, 2012).

Variations of institutional design that adopt the developmental state approach may have different economic outcomes. Institutions that compose the organisation of the state are nation specific and not homogenous (Weiss, 2000), and are a product of historical development, political process and normative regulations (Whitley, 1999). While a developmental state like Northeast Asia shows strong economic performance, different institutional environments may not necessarily be able to function similarly to the Northeast Asian developmental state style. Developing countries such as those in Southeast Asia (with the exemption of Singapore) that adopt a developmental state approach may not produce 'stellar' industrial growth like their counterparts. This is the reason why different institutions produce different developmental outcomes. Tan (2009) argues that a developmental state approach likely depends on the compatibility of the institutions and existing power structures that can affect industrial policy outcomes (p.153).

In developing countries, political institutions that are subject to wider social forces may undermine policy formations and implementation for industrial development. This links to state-society relations and the way that institutions structure distribution of power (Low, 2004). The ability of the state to manage development depends on the balance of political forces to shape the strength of the state in relation to society in contesting resources. As stated earlier, a developmental state's power lies in its capacity to transfer resources to certain productive groups for particular industrial activities. Secondly, the state must be able to resolve conflict in transferring those resources between different segments of industrial groups, this includes overriding potential opposition groups that are left out in these transferring of resources (Tan, 2009, p.155). However, in developing countries, established social classes, ethnic-based groups and an unproductive non-capitalist class exercise varying degree of political influence, which can compromise the state capacity to mobilise resources and direct economic outcome. That is, the active social groups can undermine the transfer of resources, and some unproductive social groups can protect inefficient enterprises (Tan, 2008).

In a developmental state where political elites are committed to pursue developmental goals through state-business relations, ingrained with political objectives can compromise industrial developmental outcome (Woo-Cumming, 1999). The interdependence of state and business is driven by short-term interest, as mainly political interests can be growth-reducing (Weiss and Hobson, 2000). Interdependence between state and business that has strong political consideration gives rise to the patron-client network. The patron-client network is a repeated relationship of exchange (usually through informal linkages) between patron and client. The nature of this relationship, institutionalised between state-society relationships, becomes a powerful interaction as it influences economic decisions (Gomez, 2002; Khan, 1998). The presence of strong patron influence in political institutions is unlikely to allow for planning or implementation of effective industrial policy. This is because political elites tend to extract resources to maintain clients (not based on economic consideration), and in this case resources are likely to be allocated to unproductive producers (Khan, 1998; Tan, 2008). At the same time, the client offers political based support; hence this tie becomes deeply embedded to influence the configuration of industrial policy.

Patronage in developing countries becomes institutionally constrained because the distribution of state rents (subsidies, import licences or quota) is given to those who have close ties with the governing elites. Patron–client networks breed rent-seeking behaviour to secure economic rents. An economic rent 'is a return to a resource owner in excess of the owner's opportunity cost (Tollison, 1987, p.144). Buchanan (1980) defines 'rent-seeking as that part of the payment to an owner of resources that is over and above that which those resources could command in any alternative use' (cited in Kang, 2002). Thus, rents are created when a political actor manipulates economic policy to distort prices and diverge from competitive levels. With the existence of rents, they are able to reap 'excess profit', because lucrative rent patronage is reinforced to gain access to the rents[8]. Corruption

[8] For example, import licenses confer rents by restricting the volume of imported goods that come into a country, and thus those actors able to import the restricted goods will be able to sell those goods at a higher-than-market prices, thus obtaining rents (Kang, 2002; p.180).

can occur when businessmen use bribery or other means in an attempt to influence policy decisions (Kang, 2002).

The problem with rent-seeking is that industrial policy can be captured by unproductive groups who have considerable political influence and personal connections, who organise resistance and develop ways to modify certain market outcomes politically (Alavi, 1982; Khan, 1998). Such groups continue to have access to state rent and can threaten any policy changes that undermine their interest. Furthermore, when an ethnic dimension is incorporated in the economic development due to post-colonial legacy, it marginalises certain groups. The ruling elites are perceived to only meet the material needs of certain ethnic groups in implementation of industrial policy (Jesudason, 1989). This strengthens rent-seeking behaviour and patronage between ruling elites with business groups fostered by political elites that depend on state rents under the auspice of ethnic development. Given the vested beholden interest between political and business elites, it can be difficult to transfer state rents to productive producers, which can compromise effective industrial policy implementation.

However, this does not suggest that the first tier developmental states of Northeast Asia are free from cronyism or the patron-client network, even though ethnic consideration is not their priority (given a homogenous society). Rather, the Japanese conglomerate *Keiretsus* or South Korea's *Chaebols* depends largely on state rents such as subsidies or other financial support to grow in the market. The state elites are in favour of large conglomerates to lead industrial development with a favourable investment climate, and the conglomerates are cronies of the state elites (Masina, 2002). The work of Kang (2002) and Khan (1998) reveals that patronage and money politics has been characterised as part of the industrial development of South Korea. The informal linkages between government and business exchange benefits through rent-seeking or patron-client networks, and policy interests are likely to favour certain groups of companies.

Even though patronage is part of the mode of exchange for benefits or altering policy terms (Kang, 2002), Weiss and Hobson (1995) point out that private enterprises mobilise and utilise resources for export-led growth. The existing state capacity enables the ruling elite to discipline private enterprise with market-based performance. Linkages are forged to ensure domestic companies are able to engage in industrial catch up with strong financial support from the government. The existing capacity enables the state to structure its market entry for certain foreign direct investments. Though rent-seeking may involve political and economic actors, Pempel (1999) argues that both are committed to high growth, realising that they would have to swim and sink together (p.164). The patronage in Northeast Asia is used to promote growth-enhancing policy, while in some developing countries, when political gain subordinates economic objectives, patronage promotes growth-resisting policy (Low, 2004).

The state bureaucracy in most developing countries may not easily emulate the embedded autonomy seen in Northeast Asia. As Evan (1995) points out, that embedded autonomy connects the state with productive social groups to form coordination in economic development, but should not be captured (p.70). Low (2004; 2001) suggests that once captured, it will lose its autonomy and become perverse and less *developmental* (p.5). This happens when political institutions prioritise political objectives over growth-enhancing policy, which leads to institutional constraints because elites transfer resources to accommodate certain groups that, though perhaps not productive, play an important political role in the society. Due to strong political consideration, the political elites will exert influence in the state bureaucracy to impose their interests that go beyond economic objectives. As such, the bureaucracy is no longer autonomous in economic planning and implementation of policy, because it is under the strong influence of the governing elites. Once captured by political elites and selected interest groups, state economic planning and configuration of interest reduce to private interest.

2.3 Institutional Arrangements for Policy Making

Having discussed institutionalism and the developmental state approach, it is important to note that when a country adopts a developmentalist state approach, the institutions structure political elite dominance, the role of bureaucratic unity and the conjoined effort between 'selected' enterprises. The institutions shape industrial policy formulation based on the constellation of state elites (politicians and bureaucracy) and business elites. Given such an institutional setting, the policy-making institution can be characterised as non-pluralistic. The power relations are structured to certain principle economic actors to participate in policy-making institutions and coordinate economic outcomes. Coordinating policy making is linked to the institutional arrangements formed by actors to devise feasible industrial policy outcomes. For analytical purposes, it is important to explain the *institutional arrangements* between the principle economic actors, as most institutionalist scholars, including Campbell (1997b), Wade (1990), Weiss (1998) and Hollingworth (2000), describe that institutional arrangements between political and economic actors have a profound impact on policy change and success or even failure. As Wade (1990) argues, '…it is not a matter of choosing the right industrial policy but rather depends on certain institutional arrangements'. Institutional arrangements are where bargaining, negotiation, resolving conflict and configuration of interest take place, which can influence policy-making institutions. Institutional arrangements reveal the politics of policy-making institutions, because whose ideas and preferences are incorporated in the industrial policy depends on the actor's ability to resolve conflict and assert their policy preferences. The implication is that institutional arrangements affect decision-making, economic rules and interpretation (Campbell, 1997a).

Hollingworth (2000) defines institutional arrangements as the coordination of various economic actors ranging from political elites, government, firms (local and foreign), labour unions and business associations, among others. These actors engage to resolve economic problems and determine industrial policy preferences. It can be thought of as a deliberation, where economic actors devise industrial strategy on sectional interests and reach agreement. It can also be seen as a feedback mechanism between actors to improve decisions on whether or not to continue certain policy (Thelen, 1999). Institutional arrangements involve a decision to transfer or extract resources and allocate them to certain industries. This includes resolving conflicts between groups pertaining to resources allocation. Decisions to focus on certain strategic industry depend largely on institutional arrangements taking place between political and economic actors. External changes (for example pro-market reforms or crises) or internal ones (political process) that can affect allocation of resources will also prompt actors to engage in coordination to address the adverse impact from the changes. Inevitable changes from the external environment will make actors develop various institutional arrangements to address conflicting positions (Hollingworth and Boyer, 1997).

The institutional arrangements are ways for actors to assert preferences in the policy-making institutions. For actors to impose interest, it is not just about developing feasible strategy, they also must 'frame ideas of particular interest' in line with the embedded norms and values. Discourse is a way for actors to convey ideas and frame meaning within the given context (Schmidt, 2008). Discursive elements in the institutions are seen as ways to transport ideas in policy making. How actors interpret ideas and interest within the specific context can influence whether the ideas or interest are accepted in the institutional arrangement. Utilising rhetorical device scripts and culturally accepted principles in the discourse are ways to frame ideas and to assert preference in the policy-making process.

Institutional arrangements can be made through formal institutions, where they associate with codified formal rules (market relationship). They can also be made from informal institutions, where actors' interactions and decisions are influenced by normative rules or embedded conventions (non-market relationship) (Hollingworth, 2000, p.606; Hall and Soskice, 2001; Lowndes, 2010). Pertinent to this is that the configuration of institutional arrangements to address policy problems or configure policy interests is influenced by the norms, rules, habits, conventions and values in which actors operate. If modes of configuration that are dominant in a societal context are somewhat stable, it tends to persist over time within the society (Hodgson, 1999).

Institutional arrangements depend on the distribution of power between actors to resolve problems or determine policy preferences (Hollingworth, 2000). The historical specificities, political events and normative dimension structuring economic actors' power relations can affect coordination of economic preference in policy-making institutions. Hollingworth (2000) argues that when one mode of coordination is dominant in the society, it will influence the role that other coordinating modes in play. In state-led economic development, then, there is usually an unequal form of interaction between actors in an institutional arrangement to coordinate economic outcomes (Whitley, 2003). In the case when social groups are fractured, the organised groups' interactions can be suppressed. Hence, the principle economic actors such as political, bureaucratic elites and selected private enterprises have a dominant role to exert interest in coordinating policy either through formal or informal institutions.

Coordinating industrial policy is a political process, so the political institution is the heart of the development agenda being configured (Leftwich, 2000; Whitfield and Buur, 2014). It is political, so it involves many activities of cooperation, conflict and negotiation in making decisions about the use of production and distribution of resources (Leftwich 2010, p.6). Political actors, as part of policy-making institutions, respond to internal and external environments but are shaped by ideas, ideologies, interests, and formal and informal institutions. How political actors manufacture interest to advance policy agenda depends on the role of institutions in structuring ideas and interaction between political actors (Campbell, 1997a). The interpretation of policy ideas into agenda is largely based on the normative and cognitive dimension of the elite, including how they perceive public sentiment (Campbell, 1998). Considering public sentiment (for example rapid economic development through industrialisation) is to ensure the development agenda is acceptable and legitimate in political institutions. Though the development agenda may seem unfeasible, skilful leaders can frame an agenda that appears socially acceptable. For instance, they can frame and interpret industrial policy with nationalism in convenient ways. However, history and the social context may structure goals of development, as March and Olsen (1984) argue that the political elite will pursue interests based on the 'logic of appropriateness', or what is socially acceptable. The agenda of industrial development tends to meet the material needs of the society along with acceptable, normative rules and embedded conventions.

On the other hand, ruling elites of the political parties who dominate the political institutions can control decisions with respect to the allocation, production and distribution of resources in the country (Kim, 2002). Power relations that structure executive dominance in policy-making institutions can suppress other political actors to advance interests (Immergut, 2010). Such institutional constraints enable political elites to define economic rules and defend policy preferences based on their interests. Here, the consideration of industrial policy interest may not be the overall economic welfare of the country. Rather, political objectives become parts of policy configurations. This includes the interest of the political elites' allies and their clients. Since the power is centred around the executive branch, this holds discretionary power to allocate resources, interpret policy agenda, intervene administratively, and use executive power to either secure or block policy preferences (Pongsiri 2001; Kessides 2004). What is important to the historical institutionalist view is that, actors will attempt to pursue political interests in the policy agenda, but actors tend not to pursue interests contrary to the normative or embedded conventions of the institutional design in order to maintain political stability (Thelen, 1999).

Configuration of policy interests is done through top-down hierarchical arrangements between the political institutions and state bureaucracies (Ritchie, 2009). The relevant state bureaucracies (ministry of finance, economic planning units, ministry of international trade, etc.) play important roles to carry out industrial policy goals. Bureaucracies are governed by specific formal rules, as posited in a Weberian style bureaucracy[9] (Larsson, 2013). The bureaucrats will function based on codified rules, which marks the autonomy of bureaucrats to enforce industrial policy (ibid, p.340). This is an essential characteristic of the developmental state to ensure well-functioning institutions.

However, given the variation of institutional designs, particularly where policy-making institutions are controlled by political elites, the bureaucracy can have less autonomy, resulting in no clear distinction between political and bureaucratic elites (Seidmand and Seidmand, 1994, Kim, 2002). Such a bureaucracy tends to have blurred and dense alliances between ruling elites and high-ranking officials (Seidman and Seidman, 1994). In developing countries, it is common that bureaucratic power derives from the political master (Searle, 1999). The bureaucracy is embedded with the patrimonial culture captured by elites, which makes the bureaucrats likely to function based on the interests of political elites. Once captured, the bureaucracy loses its autonomy, and eventually may sway from the Weberian ideal of bureaucracy because the technocrats no longer have the freedom to devise policy. Instead most configuration of policy is done in a way to meet the political elite's interests. The close

[9] A rational-legal bureaucrat that ensures legal and administrative interaction between society and business. However, the extent to which bureaucrats conform to the Weberian ideal depends on the national specific institutional structures (Larsson, 2013).

ties between politico-bureaucratic elites and, to a certain extent, the formal rules may be subject to *layering*, *drifting* or *conversion* in policy planning and implementation under the auspice of 'national interest' (Mohaney and Thelen, 2010).

Institutional arrangements also take place between government–private enterprises (Dogson, 2009). Coordination between government and private enterprises (linked to governing elites) can devise strategy and decisions on allocation of resources. Sharing information between the two can improve aspects of industrial upgrading, investment, human capital development and training. Institutional arrangements to devise industrial policy between government and private enterprises is part of the collaboration in pursuit of industrial development. Such arrangements can also 'force and facilitate' in pursuit of industrial strategies and catching up by governments (Streeck, 1992). Thus, the government can coordinate developmental goals while eliciting consensus from private enterprise to attain goals (Wade, 1990).

The assumption of collaboration within institutionalist perspectives is that the embedded network is used to connect with productive social groups to transform economic development (Evan, 1995). State elites and those industrial groups fostered by the elites can configure policy interests, and at the same time these 'selected' groups are able to have preferential access to state resources to grow in the market. The deliberation between government and enterprise may occur formally, such as policy discussion at the ministerial level, but the relationship between these groups and state elites is beyond formal structures (Jomo and Gomez, 2000). There are broad informal influences on the state elites' decisions onto these 'selected' groups. To a certain extent, there is unequal interaction between these groups and the state elites, because the industrialist groups rely upon state rents. Such dependency occurs in the absence of an industrialist class during the formative years of industrial development, in which the state elite uses state resources to foster such groups. As such, state elites can impose top down preferences in industrial policy.

Most developmental states do not downplay market forces (Onis, 1999), as it is necessary to promote an outward-oriented economy; therefore, formal rules (codified rules) should be in place to ensure the market functions optimally (Aoaki et al., 1997). With the presence of government-private enterprise relationships, the governing elites can shape market entry that embodies a neoliberal policy (limited role of the government) to promote a freer business environment for other economic actors. Such economic policy usually favours private enterprise interests and either foreign or local firms. Though the economic policy may appear to favour private enterprise interests, the governing elites can alter or configure policy to accommodate the interest of domestic enterprises in certain segments of the industry that have 'national interest' (Khan and Blankenburg, 2009). Accommodating the domestic enterprise interests (linked to state elites) to a certain extent can create an uneven playing field environment in the market.

Actors will also utilise informal institutional arrangements to configure policy preferences. Informal linkages, such as close-ties, are useful ways to influence policy making (Peng and Luo, 2000; Hoskisson et al., 2000). In institutional design that underpins the strategic role of the governing elites and 'selected' private enterprises in coordinating industrial development, the patron-client network becomes part of institutional arrangements for economic actors to coordinate economic outcome (Khan, 2000). The informal relationship with state elites enables industrial groups to obtain preferential access to government resources, subsidies, contracts, research grants and other financial supports. Having close connections can create privileged positions for firms in government policy (Oliver and Holzinger, 2008). Informal linkages enable economic actors to alter terms of economic policy that can either facilitate or hinder economic growth (Acemoglu and Johnson, 2005). State elites and industrial groups may utilise informal linkages to coordinate economic preferences or resolve their conflicting positions.

The patron-client network can potentially influence policy decisions, though it largely depends on the situation and the nature of the network itself (Khan, 2000; Peng and Luo, 2000). The informal mode of exchange depends on the objectives and ideologies of the patron and client, which include kinship, family ties, social class and ownership groups, or groups that provide political based support that can influence the allocation of resources (Ritchie, 2005). More importantly, the power relations between the patron and client can influence resource allocation and the configuration of policy interests. In institutional structures that have weak links between the state and society, the patron can transfer resources from one group to a client, and be able to resolve tension arising from this transfer. Under certain conditions when the patron depends on the client's political support, it is likely that the transfer of resources becomes challenging, because the client provides support for the patron in political institutions in exchange for to provide access to state rents.

Khan (2000) argues that changes associated with market-oriented reforms through privatisation or deregulation of the patron-client network become more important in coordination of policy interest. Particularly, private enterprise is headed by politically linked individuals. As competition for resources become intense, competing economic preferences in policy institutions are unlikely to be transparent. Institutional arrangements to secure policy interests are likely to take place through the patron-client network, and distribution of rents are usually done in personalised and partisan ways by the patronage system to secure rents (Khan, 2000; 2005). It is easier to transfer or maintain rents when the pre-existing institutions enable informal institutions to be pervasively exercised. Institutional-based scholars like Peng et al. (2008), Peng and Luo (2000), Powell (1996) and Hofstede (2007) share similar claims, where a close network is crucial under uncertain environments. Close ties can be deemed as 'substratum of institutional arrangements' where informal institutions facilitate the exchange of resources and information (Peng and Luo, 2000; Redding, 2005).

Configurations of economic interest and realising industrial policy choices lies in the institutional arrangements formed by actors. Principle actors that play important roles in policy-making institutions are the political elites, the bureaucracy and business groups (linked to the elites). This tripartite interaction in a particular institutional arrangement (either formal or informal) is able to mobilise, prioritise and coordinate scarce resources in policy-making institutions. Industrial policy interest is based on the constellation of the elite interest, given there is limited participation from other economic actors to advance their own interest (Onis, 1991). In the policy-making institutions, the state elites and 'selected' business groups are what Rhodes terms the *policy community*–the policy actors who share common interests, values and ideologies. Institutional arrangements made by these actors can construct the rules of the game, which in turn affect policy outcome.

Considering the policy elite in institutional arrangements, the role of institutions can either constrain or promote economic growth, performance and accumulation (Tipton, 2009; Hollingworth, 2000). On the one hand, the elites and their business alliances can negotiate, bargain and transfer resources to foster industrial development. The elite can also facilitate economic actors to behave proactively to changing circumstances and have preferential access to state resources (Ahn and York 2011). On the other hand, mobilising resources to a particular group can be constrained by their institutions, especially when the elites have already made initial investment in certain groups in a particular sector (Tan, 2009). To replace the groups (especially the unproductive ones) with other productive groups can be very challenging because the industrial groups are fostered through rent-seeking, so they may threaten coherent policy that compromises their interests (Haggard, 1998). This may hinder the governing elites from replacing them with other productive groups (Khan and Blankenburg, 2009)[10]. As such, this can lead to rigidity among the governing elite that can impede economic policy changes, and likely limit the capacity to grow.

[10] Tan (2009) suggests the elites have the ability to arrange side payment to reduce those industrial groups lost due to policy changes, the chances to replace industrial groups to another productive group is higher.

2.4 Integrated framework: Politics of Malaysia's Policy-Making Process

The theoretical discussion in the previous section will be used to frame and analyse the political economy and politics of Malaysia's policy-making institutions. The role of institutions, which this research leverages from historical and sociological perspectives, explains how institutions shape and facilitate the interaction of principle actors, and how they are subjected to wider institutional constraints based on political events, social context and historical specificities (Thelen 1999; Steinmo, 2008). The power relations structured by the institutions affect interactions between actors. Furthermore, the normative dimension (values, embedded conventions, habits) also influences how actors' behaviour operates in a particular institutional setting (Dimaggio, 1998; Scott, 2008). Hence, the role of institutions is to be the 'rules of the game' that constitute 'how things get done' in the policy-making process. Incorporating the developmental state approach explains how developing countries envision pursuit of long-term industrial development. The developmental state paradigm posits that the institutions of the state are structured by governing elite dominance, the role of bureaucracy and government-private relations (Moon and Prasad, 1994; Haggard, 1998; Onis, 1999). The institutional design enables a reciprocal relationship between government and private enterprise a way to design industrial policy to facilitate the growth of the domestic enterprises. The institutional arrangements underpin the role of political, bureaucracy elites and selected business groups to configure industrial policy preferences. The 'triangular arrangement' between these actors constitutes a vital policy community and their interactions have an impact on industrial policy.

The strategic role of the state elites (politicians and bureaucrats) and selected business groups in configuring industrial policy preferences implies that the policy-making institutions limit only certain actors to advance policy interest. Given that the institutions limit other social groups organised collectively, this enables the elites to mobilise, coordinate and prioritise resources in policy-making institutions. Institutional arrangements are formed by state actors (politicians, bureaucrats) and selected business groups to exert interest in the industrial policy-making. This indicates that policy-making institutions do not operate based on economic pluralism[11]. Rather, policy ideas and agenda for industrial development is based on the constellation of elites' perspectives. In short, the preferences of industrial policy are a function expressed by institutional arrangements formed by state elites and selected business groups' interests.

[11] Economic pluralism refers to 'policy outcome as a function of political conflict shaped by the preferences of different actors, weighted by their market power and their propensity for collective action' (Garret and Lange 1996, p.49).

In the context of Malaysia's policy-making institutions, when the country adopted a developmentalist state approach it underpinned the role of the political elites, bureaucrats and 'selected' business groups. In this research this is framed as a 'triangular arrangement'. These main actors are deemed as a policy community that can construct the 'rules of the games' (see figure 2.0). Institutional arrangements between these agents are crucial to configure industrial policy. The institutional structure of Malaysia's economic policy making is best explained by the reference to the 'alignment' of the relationship between political, bureaucratic and business elites (Leigh, 1992). The direction of policy changes is interrelated with the three core actors' interactions. Horowtiz (1989) describes that in most late-industrialising countries like Malaysia, the policy-making environment is a 'centrally directed exercise' where there are limited participants in the policy process because channels for participation are limited.

Considering the historical specificities and social context in Malaysia, the power relations in the institutional arrangements lie in the political elites (executive branch) (further explanation below). That is, the existing structures enable the political elite to drive the policy development agenda. As a developmentalist state, 'the political elite are able to fend off distributional demands from other factions or individual within the ruling coalition, also to overcome resistance from societal groups to changes in institutions and rules which govern economic benefits' (Whitfield and Buur, 2014, p.128). As such, the political elite can come out with industrial policy preferences and agenda. Having control of the political institutions and agenda setting, the political elite can transfer and allocate resources to drive certain segments of industry, under the rubric of national development (Doner, 1992). Pertinent to Malaysia's political institutions is the ethno-economic development of the Bumiputra group, which becomes a central part of political consideration in the industrial development project. The ruling coalition, which is led by UMNO and represents Bumiputra's interests, has dominant role to secure the ethno-economic requirement in policy-making institutions.

There is a close reciprocal relationship between the elites and selected business groups, such ties that exist during the formative years of industrialisation where this is an absence of industrialist groups, so most business groups are fostered by political elites who enable them to have access to state resources. The business groups can be labelled as a 'rentier class' (Searle, 1999; Gomez and Jomo 1997; Tan, 2014) that has grown dependent upon rents generated by state elite. An important consideration in the context of Malaysia is that there are existing well-established industrial groups in the society. However, when ethnic consideration becomes part of developmental projects, the political elite by-pass the existing industrial groups and create new industrial groups that are ethnically determined (Jomo, 1990). The new business groups, in this case selected Bumiputra groups who are dependent on the state rents. The arm's length relationship between the ruling elite and business groups enables them to adjust policy terms in favour of the growth of groups. The ruling elite can divert resources to reduce risk for the group to invest in the market, even though in certain segments of the industry there is no comparative advantage. The state is able to facilitate through macroeconomic policy adjustment and allocate sufficient resources to grow with less opposition forces from other societal groups. Since this group relies on the ruling elite to obtain access to state resources, power relations tend to lie with the political elite. This enables the political elite to influence the direction of the business group, since it relies on state resources. Patronage then becomes the mode of exchange or interaction, due to interlocking interests between the political elite and the 'selected' business groups.

The dominant role of the political elite to formulate the industrial policy preferences agenda—is necessary but not sufficient. The political elite must have a significant degree of control over the state bureaucracy to exert interest in industrial policy implementation. In the case of Malaysia, the politico-bureaucratic relationship enables the elite to control the state institutions in the policy-making domain and direct economic outcomes (Searle, 1999). The role of the bureaucracy is to realise the policy interest of the elites and devise policy for the business groups to grow in the market. Here, the bureaucrats act as operating agents to the political elites and connect them to social groups (that may not be productive) whose function is to meet their interests. Certain predilections and biases towards industrial policy are expected to ensure the groups' economic interest is likewise secured (Aun, 2004; Khalid and Abidin, 2014). Industrial policy being formulated tends to give certain privileges (implicit or explicit) to domestic enterprises such as low tax, de facto protective measures and financial supports or subsidies. Terms of policy are negotiable (either through formal or informal linkages) to facilitate the growth of the enterprises.

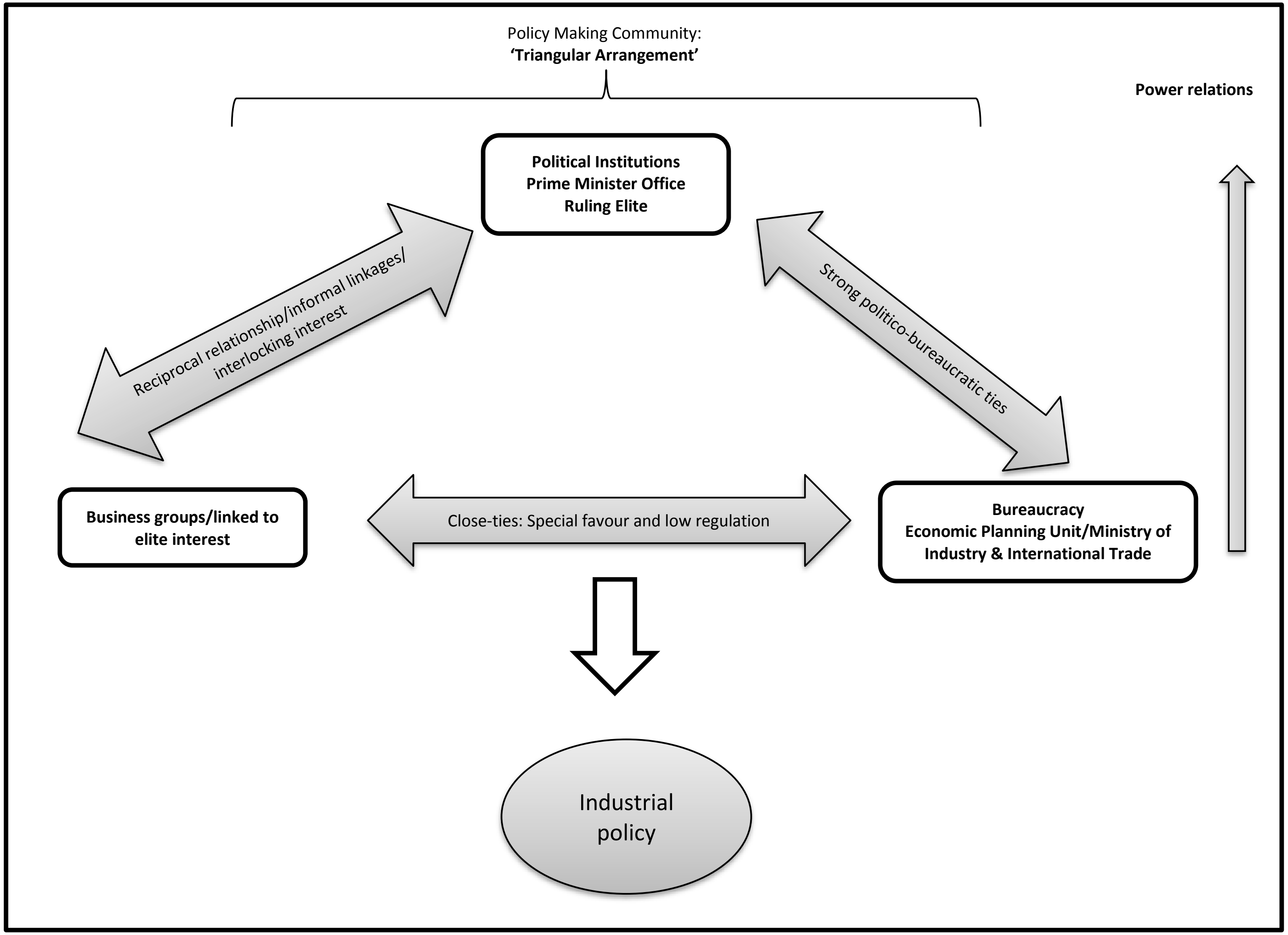
It is important to discuss the specific political institutions in Malaysia in order to further understand the political economy of policy-making institutions. The United Malay National Organisation (UMNO) is the main Malay political party that represents the interests of the largest community in Malaysia. UMNO has also built a political coalition as a means of power-sharing between the other main non-Malay political parties, including the Malaysian Chinese Association (MCA) and the Malaysia Indian Congress (MIC), as well as other minority political parties (Gomez, 2008). The ruling coalition is led by UMNO and has been the government for more than half of a century, since the formation of Malaysia in 1963. President of UMNO led BN will be the head (Prime Minister) of the executive government.

Although a recent new political development has deteriorated BN's popularity[12], their long domination in the executive and legislative branch has given their political elites the primary role of deciding industrial policy preferences (Ansori, 2013).

Malaysia's political institutions can be described as a consociational democracy, which refers to a government by elite cartel where political order might be maintained through power sharing so that the main ethnic communities are all represented in the government (Lijphart, 1977). In this sense, the consociationalist approach posits that there is somehow equal access for the elite from each ethnic group to compete for resources in the policy-making domain to reduce political tension (Means, 1991; Nordlinger, 1993; Noh, 2013). Political fraction is reduced through this inter-elite bargaining and accommodation to foster inter-ethnic cooperation (Crouch, 1996). Inter-elite bargaining enables the political elite to set the rules of the game in their institutional structures, define how things are done and set a decision-making process based on formal and informal rules. This enables the country to meet the political and economic interests from each ethnic group to form a stable government (Leftwich, 2000).

[12] In both general elections in 2008 and 2013 the ruling coalition, Barisan Nasional, has lost the two-thirds majority in the parliament.

Table 2.0 **Institutional Arrangements for Malaysia Policy Making Process**



Power sharing in the political coalition has changed after the racial riot in 1969. This episode changed the 'rules of the game' in the political institutions (Crouch, 1996). The riot happened due to the Chinese, who dominated the commercial and business activities, a fact that did not sit well with the majority Malays who were lagging behind in the mainstream of economic development. This created a critical juncture that changed the political inter-elite bargaining. The political institutions had structured the power relations to lie in the UMNO, which increased the Malay bargaining power to command economic resources (Noh, 2013; Mauzy, 1993). The ethnic disparities prompted the Malay political elites to correct economic imbalances with the formation of the New Economic Policy (NEP) [13]. The NEP is an affirmative action policy that institutionalised ethnic imperatives in socio-economic development policy. In the institutional context where 'race matters', the political elite (UMNO led coalition) may repress other ethnic groups' access to resources through what Mauzy (1993) terms as 'coercive consociationalist'. That is, the less dominant ethnic groups (for example the Chinese and Indian) tend to compromise with the more dominant ethnic group (Bumiputra) in the policy-making process.

When the state adopts a developmentalist state approach to pursue industrial development, executive branch in a political institution has the dominant role over the policy formulation. The long domination of BN in the executive branch has implications on the role of parliament in policy formation. Policy ideas and problem recognition are confined to the executive branch, and though consultation takes place, discussion is limited to close allies to the Prime Minister (Leong, 1992; Gomez and Jomo, 1997; Lee, Aun, 2004; Chin, 2010). The parliament is supposed to be a check and balance for the policy arena, but it does little more than 'rubber-stamp' executive decisions (Brown et al., 2004; Khalid and Abidin, 2014). The longevity of the ruling coalition has rendered the executives with considerable power to impose their interests in the policy-making institutions.

Bureaucracies in a developmental state are important institutions to plan and implement economic policy. As stated earlier, in a developmentalist approach, technocratic elites play an important role in planning and enforcing economic policy. To this end, the political actors provide freedom for the technocrats to formulate and implement policy (Evan, 1995; Johnson, 1999). The space for the bureaucracy to act independently enables the bureaucrats to learn, get information from relevant R&D, formulate coherent economic policy and deploy effective coordination across the agencies to implement industrial policy at a target sector (Ritchie, 2009). Here, the political actors provide vision

[13] This affirmative action policy has been the guiding principle for distributive strategy for the subsequent government grand policy (Gomez, 2012; 2016) that is National Development Policy (NDP) (1990 – 2000), National Vision Policy (NVP) (2001 – 2010) and the recent New Economic Model (NEM) (2010 – 2020).

for the developmental goals in the policy, while bureaucrats implement it independently with less private intervention. The policy recommendation for the political actors mostly comes from the bureaucracy (Woo, 1999). The bureaucracy has to connect with the most productive groups in the society to form coherent industrial policy. Access to state resources are devised at the state bureaucracy to facilitate how selected industrial groups can grow in the market.

However, bureaucracy captured by executive dominance enables the political elite to have dominant control over the state's institutions. Thus, the policy process tends to have a top-down approach, orchestrated by the political elite. Strong politico-bureaucratic nexus and institutional arrangements between them can influence the configuration of policy planning (Loh, 2015). Although the state bureaucracy operates based on the Weberian ideal, the task performed is based on codified rules (Lim 2002). Through executive dominance, a political institution is able to intervene in bureaucratic institutions to exert their interest in the policy-making process (Chin, 2011). Bureaucratic institutions, captured by elites or their allies, enable them to secure compliance with the top government officials to realise policy interests despite possibly not being based on economic consideration (Menon, 2009). The politico-bureaucratic ties have rendered *layering* or *drifting* rules and policy to serve the interest of the governing elites (Siddiquee, 2006).

Strong politico-bureaucratic ties in Malaysia enable reciprocal relationships between political and bureaucratic elites. Particularly when the state begins to intervene in the marketplace to steer industrial development, the governing elites seek ways for the state institutions to realise elites' policy interests. As Ham and Hill (1984) point out, bureaucracy is an important source of power for governing elites to pursue interest in the policy domain (p.53), and the dominant role of the political elites can exercise strong intervention in the bureaucracy to direct policy formation and implementation. The bureaucracy has considerable power in policy making because the state institution can mobilise revenue, come out with detailed planning, and implement funding and regulations, though policy interests largely come from the governing elites. Intervention from the political elites in policy implementation has somehow compromised the technocratic ability of the economic bureaucrats to carry out economic policy (Lim, 2002; Loh, 2015).

In Malaysia, policy-making institutions structure the Prime Minister's office and his department plays a central role in determining the broad direction of industrial policy. Following the developmental state approach, a key pilot agency to plan economic policy is essential to organize and direct industrial outcome. The Economic Planning Unit (EPU), part of the Prime Minister's department, is the primary site of the policy-making process. It has overarching influences over policy strategy and influences the allocation of resources. The unit is in charge of overseeing the development and implementation of medium and long-term economic strategies (Brown et al., 2004, p.9). The EPU is one of the principle agencies in configuring economic policy, and it provides policy input to the highest level of decision-making of the country (Embong, 2012). The agency is staffed by technocrats who have specific expertise on economic policy (ibid, p.224). However, Henderson et al. (2002) point out that since the 1990s there has been a gradual demise of innovative-policy making at the EPU. The centralisation of economic policy making that revolves around the Prime Minister and private enterprises enables the elites to influence the state bureaucracy. Henderson et al. (2002) argue that the central site of economic policy formation, such as the EPU, has become an 'operation-oriented' body, rather than becoming technocrats to serve as an advising agency. In general, the EPU remains an important agency in daily operations, it obtains feedback from diverse social groups, provides technical evaluation and policy recommendations.

The Ministry of International Trade and Industry (MITI) is also one of the primary government bodies involved in policy formulation, inspired by the Japanese model. The key state bureaucracy, MITI plays a strategic role in planning and implementing policy. This ministry was established by Mahathir, then deputy Prime Minister, to oversee industrial development. This ministry, along with the EPU, coordinates industrial policy and makes necessary adjustments to the terms of policy to facilitate domestic enterprises. The MITI and EPU both hold formal policy discussions with various private sector and civil societies group with regards to annual budgets and other policy recommendations. This may present a formal open structure for other groups to provide policy input for the policy maker. However, Brown et al. (2004) observe that the formal policy dialogues may not achieve anything concrete because economic preferences and decision making is still largely centralised to the state elites (p.8).

Policy interest of the industrial groups (linked to governing elites) in the institutional arrangement can have impact on maintaining the status quo or bringing changes in industrial policy (Tan, 2015). They have the influence because the governing elites have interlocking interests with the business groups, since these groups are formed by the state elites and usually have close ties with the political elite. The close ties are further strengthened when the government under Mahathir's administration introduced its privatisation plan in the early 1990s, to transfer state-owned enterprises (SOE) to private ownership under the rubric of improving efficiency. The privatisation was a response to the SOEs crowding out the market during the NEP period. This led the government to privatise most SOEs. The privatisation plan was intended to create wealth for select individuals (not exclusively Bumiputra groups but other politically linked individuals as well) to run the formerly state-owned enterprises

(Felker, 2003; Jomo, 1999). Thus, privatisation is not done in a transparent manner (Jomo and Wee, 2014), as the political elite handpicked rather than picking the winner to head private enterprise.

Patronage in appointment makes those who have close ties with the political elite the main beneficiaries in a privatisation plan. This forms a strong patronage between the business group and governing elites. The privatisation plan forms a high-level state-business network crucial in formulating policy. There is broad exercise of the patron-client network to enable business groups to have access to state resources through 'unusual' institutional arrangements (Tan, 2008). On another note, Jomo (1999, p.5) and Gomez (2016; 2009) argue that the formation of the business group can become an important way to support and subsidise politically well-connected individuals. The existing institutional arrangement evolves around elites and with a strong patronage system, it is easily susceptible to regulator and political capture. Regulator captures are associated with favouring certain producers (even unproductive groups) over consumers. Political capture refers to when regulation becomes a tool for self-interest of the political elites (Tan, 2008). Consequences of regulatory and political captures lead to credible commitment problems in policy, misleading policy enforcement and biases in the mobilisation of resources.

Informal institutions can be powerful modes of exchange (Peng and Luo, 2000), given that existing institutional structures underpin informal rules to influence economic actors' interaction. As such, other private enterprises (not linked to state elites) or business associations will form informal institutional arrangements to exert their influences in the policy-making domain. Informal linkages include lobbying with principle economic actors to be exert their policy interest. Other economic actors may attempt to utilise the patron-client network to form institutional arrangements to advance or secure policy interests (Loh, 2012).

The role of international and regional institutions has implications on the institutional arrangements in Malaysia's policy-making institutions. As part of the international trading system, Malaysia has to embrace some of the reforms required by the international or regional institutions in order to engage in global productions. The overarching objective of the World Trade Organisation (WTO) is to promote freer international trade regimes (Hoekman, 2002). There are a few basic principles that govern freer trade such as (i) non-discrimination, which has two features: most favoured nations (MFN) treating other people equally[14] and national treatment treating foreign and locals equally[15]; (ii) freer trade through negotiations; (iii) binding commitment and predictability; (iv) promoting fair competition[16]; and (v) encouraging development and economic reform (see WTO). The WTO involves a complex multilateral negotiation. Often it takes a longer period of time for member governments to agree on the binding commitment (Hoekman et al., 2002). On the other hand, regionalist projects like ASEAN give more flexibility for member states to negotiate regional trade agreements (RTA) like the ASEAN Free Trade Agreement (AFTA). RTA are an important trade policy tool to complement the multilateral trading system under the WTO (Fiorentino et al., 2007). This is the case so long as the RTA is consistent with the basic principles of the international trading system, specifically with non-discrimination. An RTA formed must minimise opportunistic behaviour that aims to discriminate against non-members (Hoekman and Schiff, 2002). Whether it is multilateral (WTO) or regional trading agreements (AFTA under ASEAN) both advocate trade liberalisation. The institutional arrangements involved with both institutions are market-based, whereby regulation is formed to reduce anticompetitive behaviour from trading partners (Freund and Ornelas, 2010; Balwin, 1994). This is done to form a market-friendly environment, hence trade policy arrangements between members state are made to coordinate a freer trading regime. Trading partners have less barriers to enter the market and can expand market access without discrimination.

Malaysia's status as a member state to both the WTO and AFTA cannot ignore institutional arrangements coming from the international and regional trade agreement. Institutional arrangements from the agreements are made to expand market access for trading partners. Although wider market access could improve the overall economic welfare of the state, however policy actors are inevitably influenced by the domestic political economy demand (Tham, 2015). This is true especially when the presence of 'selected' domestic enterprises are framed as 'national interests' along with an ethnic imperative in which elite policy actors have substantial interests. Trade liberalisation is unlikely to occur straightforwardly because political actors will act according to what is appropriate based on the institutional context (Hall and Taylor, 1996). What is appropriate also depends on the elite policy actors' interpretations of the phenomenon (March and Olsen, 1989).

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[14] MFN means member countries cannot discriminate between their trading partners by granting someone a special favour such as a lower tariff customs duty rate (see WTO https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

[15] National treatment means giving others the same treatment as one's own nationals. Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market (see WTO https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

[16] "Unfair" practices such as export subsidies and dumping products at below cost to gain market share.

The multilateral and regional trade agreements will bring about pro-market reforms, where institutional arrangements are based on market relationships. This may limit the role of government in the marketplace. Having less control over the domestic economy (due to multilateral and regional agreements) may undermine the national interest and the growth of domestic enterprises in the marketplace. Hollingworth (2000) pointed out that the market relationship operates based on rules (with limited role of the state) to ensure that the market can operate at an optimum level. However, the institutional design underpins the role of the political elite, bureaucracy and 'selected' industrial groups in policy-making institutions. This provides the capacity to develop policy options to protect domestic enterprise interests. They are able to do so because the elite policy actors dominate policy institutions. There is limited access for other actors to influence policy for pro-market reforms.

The triangular relationship between these actors can structure market entry, as most developmentalist state approaches would structure a market-friendly environment while the state retains its strategic role facilitating the local private enterprises (Amsden, 2001; Whitley, 1999). Therefore, rules can be formulated to support a non-discriminatory environment, but at the same time the elite policy actors can come out with institutional arrangements to favour the interest of the 'selected' domestic enterprises. Given that there is a strong reciprocal relationship between the government and domestic enterprises, institutional arrangements between them can craft policy space to protect the interest of the local private enterprises (Tham, 2004a; 2015). It is expected that policy change will occur against the backdrop of trade liberalisation. The close links between elite policy actors can alter old rules to form new ones, and re-interpret old rules within policy arrangements. Policy can be interpreted in a way that champions pro-market reforms, but institutional arrangements (formal or informal) between the elite policy actors and domestic enterprises can configure ways to craft policy space to coordinate the market to favour the 'selected' local enterprises. At the same time, they can devise select access to state resources to facilitate those enterprises to grow in the marketplace. Though multilateral and regional trade agreements are intended to create a freer trade regime and reduce market barriers, the state retains its strategic role to secure the 'selected' domestic enterprise, especially those enterprises linked to nationalist economic projects along with ethno-economic development (Doner, 1992).

2.5 Conclusion

To recapitulate, the aim of this research is to understand the politics of industrial policy formation for a late industrialiser like Malaysia. While industrial policy has had significant impact on growth for developing countries over the past decades, this has prompted scholars to probe into the countries' institutional structures. This theoretical frame uses neo-institutionalism to understand how variations of institutional design can structure the organisation of political and economic actors and their relationships differently. The historical and social contexts of particular institutions influence the interaction of principle actors, which has implications in the policy-making process. The developmental state approach structures the strategic role of the state elites (politicians and bureaucrats) and selected business groups in policy making. Typical developmental state economic planning and coordination are orchestrated by the elites with less interference by organised groups. This gives advantage for the governing elites to mobilise, prioritise and coordinate policy preferences in the policy-making institutions. The governing elites have control over institutional arrangements to construct 'rules of the game', enabling elites to influence the policy-making institutions based on their interests, which can fall under the rubric of national development.

The discussion also explores institutional arrangements between economic actors, which elucidate how actors form institutional arrangements to reconcile and coordinate policy preferences. In a country that adopts a developmentalist state approach to development, the political and economic actors can form institutional arrangements to reconcile economic problems, promote interest and aggregate preferences to take place beyond arm's length relationships. The reciprocal relationship between state elites and domestic enterprise linked to the elites enables elites to configure policy accommodating the interest of their business allies in the market. The structures of power relations in the institutional arrangement also influence the coordination of economic preferences. In each mode of institutional arrangement, it can be argued that the continuum of power relations lies within the state elites.

In the context of Malaysia's policy-making institutions, the tripartite arrangement between political elites, bureaucrats and domestic industrial groups (who are linked to state elites) can determine policy choices. The governing elites can come out with developmental goals and they have the power to adjust and refine policy formulation. The elites can also provide preferential access to state rent for industrial groups. Institutional arrangements form these actors is crucial in configuring and interpreting policy preferences.

Chapter 3

Methodology

3.0 Introduction

This chapter discusses methods used in this study and describes the research focus, data collection strategies and analysis. This research uses a qualitative approach to explore, describe and understand the dynamics of the politics of industrial policy process in Malaysia. The National Automotive Policy (NAP) is used as a case study since it is the central part of Malaysia's heavy industrialisation programme. The state has substantial interest in the NAP given the presence of the national car maker. The automotive industry is one of the strategic focuses for UMNO-led BN for Bumiputra developments. This study ventures to uncover the key question of the research, which is: What are the institutional arrangements evolving around the national automotive policy? It also seeks to explore how principle economic actors coordinate, mobilise, and prioritise resources and economic preferences in policy-making institutions. This will reveal the politics behind Malaysia's policy-making institutions.

The politics of Malaysia's policy-making institutions are subject to the institutional context which is influenced by historical events, power relations, norms and embedded conventions. Since it is context dependent, the method needed to gain understanding of the political reality requires a qualitative inductive inquiry. Such inquiry enables a researcher to 'get in touch with the reality' by exploring the economic actors' actions, knowledge and beliefs in configuring economic preferences. Remaining grounded in the real-life context of the policy-making process can provide an in-depth analysis of the politics of policy making in Malaysia. This chapter first provides an explanation of the rationale of the research methodology. Secondly, a discussion will be made on the data collection strategy, including the use of secondary data and the primary data collected through elite qualitative interviews. The last section will explain the details of data analysis and interpretation of data in this study.

3.1 Research Methodology

This research aims to explore and understand the politics of policy-making process and institutional arrangements made by economic actors in Malaysia. To gain deep understanding of the dynamics of the politics of industrial policy process, specifically on the national automotive policy, this research will employ a qualitative approach. As discussed in earlier chapters, this research utilises the theory of institutionalism, employing historical and sociological perspectives. It also utilises the developmentalist state approach to make sense of and explore the political phenomenon of policy-making process within the national automotive policy. The theoretical framework developed in this research underpins the strategic role of the state elites (politicians and bureaucrats) and government-private reciprocal relationships able to mobilise, prioritise and coordinate economic interest in the national automotive policy, which constitutes a central part of the country's heavy industrialisation programme. Through qualitative study, this research ventures to uncover, describe, explain and interpret the politics of Malaysia's industrial policy-making institutions.

Methodological considerations are linked to both ontology (nature of reality) and epistemology (how to make sense the reality) in order to seek answers through the research (Furlong and Marsh, 2010). In this research, industrial policy making is a political process, so the nature of the reality (ontological position) and the policy actors' behaviour are affected by the institutions they are embedded in. Policy elites' actions are subject to and shaped by historical specificity, power relations, values and embedded conventions. The institutional context can influence how policy elites behave, create world views and make sense of reality. This has implications on how policy actors perceive preferences and priorities in industrial policy, which in turn can produce different developmental outcomes. Therefore, to understand the politics of industrial policy, specifically in the automotive industry in a developing country, there is a need to understand the purposes behind the institutional arrangements and policy configurations in the policy-making institutions (Guba and Lincoln, 2005).

Epistemology is making sense of reality or, more specifically, how we can know about it (Furlong and Marsh, 2010). To explore the politics of industrial policy process requires an understanding of the views, opinions and experiences of relevant policy makers. This includes how they prioritise and coordinate resources and how they respond to social events within the institutional context, which can only be understood through the interactions of the policymakers. Interactions can reveal the 'story' of the policy-making process and the politics behinds the policy arrangements. The 'lived experience' from the policy actors is able to explain the subjective social reality of policy-making institutions.

The subjectivity of the policy-making phenomenon indicates that explanation of the event cannot be separate from its contextual setting (Porta and Keating, 2008; Shavelson and Towne, 2002; Vromen, 2010). In particular, research on politics of industrial policy process shows it is influenced by historical events, power relations and the overriding concern of ethno-development. The political phenomenon of policy activities is thus best understood through qualitative inductive studies. Such approach attempts to explore and describe the complex social reality in more detail, with in-depth analysis particularly in the area of politics of policy process (O'Leary, 2004). In-depth analysis provides rich description and captures the nuances of the intersubjectivity of the policy-making reality. This is in contrast to a quantitative approach, which emphasis objectivity by drawing upon observable facts governed by strict, natural and unchangeable laws. A quantitative explanation of political phenomenon is less context specific, making this approach less sensitive to the intersubjectivity of the political reality (Sarantakos, 2005). A qualitative research, however, is sensitive to the specific context (Furlong and Marsh, 2010). For instance, in this research this includes history, power relations, and normative aspects of the social reality, which are usually difficult to measure, as opposed to quantitative research that attempt to be value free. Such an approach attempts to reduces biases without strongly emphasising the value or normative aspects of the research subjects (Creswell, 2014; Porta, 2008). Quantitative approach unable to immerse in and engaged with their context-specific reality (Patton, 1990)

A qualitative approach is concerned with the cognitive aspects of the research subjects' (respondents) knowledge, attitudes and beliefs. The research subjects' worldviews largely construct the social reality within the institutions they are embedded in. Placing the research subject at the forefront of the phenomenon of interest, data can be derived from the interaction process to help understand the events from the participant' perspectives (Bevir and Rhodes, 2015; Merriam, 2009). Interaction via qualitative interviewing with the research subject can reveal the complex policy-making process because researchers can further probe the meanings of the complex political phenomenon in the policy-making process. This provides insights into the politics of policy making, while enabling the explanation of the phenomenon to come from a real-life context and from the perspective of those who experience it (policy actors) (Yin, 2009; Patton, 1990).

To study the complex reality in the context of qualitative research activity the researcher themselves is the key instrument data collection and interpreting the data (Lincoln and Guba, 1965). So the interactive role of the researcher with the research subjects can reflect, describe and interpret the social reality of the policy-making process. Since the premise of a qualitative approach is based on interpretive inductive process, the researcher as interviewer constructs data after the inquiring process with the research subjects (Creswell, 2014; Merriam, 2009). Such inductive reasoning enables the researcher to learn the meaning of the political reality of policy process from the respondent's viewpoint. The researcher's role in learning and making sense of the data through participants' 'lived experience' shapes the meaning of the data (Finlayson, 2004).

A qualitative approach enables the researcher to expand, confirm or disconfirm, and generate theory (Creswell, 2014). Qualitative research works to build a theoretical framework by eliciting themes and concepts from the existing theory based on reviewing the literature in a field (Weick, 1989; Blalock, 1979). It can then be developed as a theoretical lens to guide the research, which later can generate and expand the theoretical framework developed throughout the qualitative inquiry (Parson, 2010). The theoretical framework for this research is built upon the theory of institutionalism, the developmental state and other identified themes to guide the research inquiry. While data generated from the studies is used to make sense of the political phenomenon in policy-making institutions, it is also used to further refine the theoretical framework, as Silverman (2009) points out that qualitative research requires a reciprocal relationship between data and theory. Data is essential to generate a proposition or to make sense of the a priori theoretical framework. The themes that emerge from the theoretical framework are used to guide the studies and further refine the theory after the data collection and analyses.

In short, using a qualitative approach enables the exploration of the politics of industrial policy process in Malaysia, given there are variations in institutional design and developmental strategies across the nation. This empirical investigation enables the understanding and description of economic actors' actions and the decision-making process within the nationally-bound institutional design (Steinmo, 2008). The role of institutions in policy making can prescribe and proscribe the interactions of economic actors, hence it is in the interest of the research to investigate the institutional arrangements that can reveal the politics behind of the economic actors to coordinate economic preferences. This can give a deeper understanding of the political rationality and economic interests among policymakers, since there is scant attention in the literature to politics in Malaysia's industrial policy-making institutions using a qualitative approach.

3.1.1 Case Study

This research will adopt a case study as a methodological tool to explore the institutional arrangements evolving around Malaysia's national automotive policy. Using case studies as a tool emphasises an in-depth study of the social phenomenon, unlike a quantitative approach that seeks causal relationships between variables drawing on large scale (Large-N) case studies (Hopkins, 2010; O'Leary, 2004). Since qualitative research relies on in-depth study, a single case or a small number of cases is sufficient in the context of this research to elicit information and identify patterns (Porta and Keating, 2008). This includes deriving themes through the data analysis process. The study of Malaysia's NAP as a case study can highlight the politics of industrial policy making and institutional arrangements formed by economic actors, as Kirsten at al. (2009) points out that leveraging on a small case study can focus on uncovering insights into the institutional arrangements, such as characteristics that prescribe interactions, incentives and power relations. The NAP is crucial because it is linked to the heavy industrialisation programme introduced in the mid-1980s, and thereafter the national car project was launched with an emphasis on Bumiputra development. The programme considers that the state adopts a developmentalist state approach to modernise the country's economy and to diversify industrial structures. The government has considerable interest in this state-led industrial development, which highlights a political dynamic in the policy process where the state elites and their private enterprise alliances attempt to preserve their interest.

Yin (2009) points out that case studies as 'an empirical enquiry that investigates a contemporary phenomenon in-depth and within its real-life context' (p.14). It is a tool to provide a level of detail and understanding of a complex and distinct phenomenon. The case study lends itself to seek *what, how* and *why* answers, which provide extensive descriptions of the social phenomenon. By using case study this study enable the researcher not only understands the details of the policy activities but also captures the nuances of the politics in the policy-making institutions. Yin (2003) suggests that the advantages of case studies in qualitative research include: (i) Investigating contemporary issues not divorced from real-life contexts. The research inquiry does not just focus on contemporary phenomenon but also on historical events; and (ii) A social reality that is contextualised and difficult to separate from its context. For these reasons, the study of Malaysia's national automotive policy is suitable because the nationally-bound institutional context organises economic and political actors differently in policy-making institutions.

While a single or small case study is one of the prominent features of qualitative study (Bennet and Elman, 2008), it is also one of the weaknesses of this approach. Because qualitative study does not have a 'generalisation' ability, this contrasts with quantitative studies that employ a large case study to provide the ability to generalise the causal relationship of the social phenomenon (Hopkins, 2010, p.300). However, this research seeks to create an in-depth study to understand policymakers' viewpoints and the reality of the politics of the economic policy process, particularly in regard to the national automotive policy in Malaysia's institutional context. What matters in single case studies is the richness of the description and details of the events that count (Creswell, 2014; O'leary, 2004). Considering the weakness of a single case study, this research aims to gain a deeper understanding of the policy-making institutional context, which remains appropriate for a single case study (Yin, 2003). Therefore, using the national automotive policy as a case study enables empirical investigation to provide valuable insights into the political reality in policy-making institutions.

3.2 Data Collection

3.2.1 Secondary data

This research will draw upon a wide range of secondary sources through documentary research. Scott (1990) describes documentary research as an artefact produced by individuals and groups in their course of every practice and in addressing immediate practical needs. It has purpose and assumptions, which can be used to infer past experiences. Though they do not interact with the research subjects, sources from the documentary research in qualitative inquiry are useful to understand issues relating to politics in policy processes. So the contents in a document can become objects of analysis by studying the meaning they give to the political context they originated from (Vromen, 2010, p.262). Document research can provide a 'behind the scenes' view of problems that may not be directly observable and can provide the researcher with a good source of background information (Merriam, 2009). Based on this view, for this research sources on the politics of industrial policy making have been collected from scholarly journals, reports from international agencies and policy reports from think tank institutions in Malaysia. Other sources of documentary analysis also include media reports, newspapers, internet news portals, blogs and magazines. Secondary data was also obtained from policy documents, government reports and official speeches (for example, from the Ministry of Finance, Economic Planning Units, and Ministry of International Trade and Industry) which are publicly available and accessible on websites. However, some policy documents could only be obtained at the site of the respective ministries or government agencies. During fieldwork I managed to obtain some classified reports, however some government reports at the ministries relating to ministerial decisions on automotive issues were unable to be shared by public officials due to the Secrecy Act for some documents.

Data derived from the documentary research process is used as a source to understand the politics of policy issues and to verify the understanding. It helps to infer the policymakers' standpoints and intentions in the policy process. This also helps to interpret the politics of industrial policy in the past, as Scott (1990) argues that documents are a visible sign of what happened historically that can be useful to understand the past and as well as the present. As documents cannot be taken for granted (Scott, 1990; Mogalakwe, 2006), documentary research should identify limitations or unclear meanings of the subject under investigation. This study uses documentary research as a source of identifying patterns of policy changes and some discrepancies, including ambiguous meanings of the policy content. It is a useful method to further investigate the issues during interviews.

Paying attention to the data from mainstream media or news from social media is important because information presented can be biased in some newspapers or in news portals on the internet. Some of these information sources are pro-government while others can be pro-opposition. Information given can be one-sided depending on who produces the news. While the media may present some biases, it is also a good starting point to think about the issues and for further verification. However, it is important to note that documentary research cannot rely on one source to make judgments on the policy issues. Other sources are also necessary to understand issues relating to automotive policy; hence reading, understanding and interpreting the information from public sources must be carefully done. The documentary analysis is useful in this research to verify the interviews with key policymakers regarding policy changes and arrangements being made. This provides valuable insights into the politics behind institutional arrangements in relation to the national automotive policy.

3.2.2. Primary data

Fieldwork for this research was conducted over a three-month period in Malaysia in 2016. During the fieldwork, primary data collection was the main source of empirical data. Primary data was collected through 'elite interviews'. Though in this context elite interviews refer to interviews with actors involved in the policy-making process, it is important to also note that the term 'elite' does not necessarily refer to someone of high social, economic and political standing. As Hochschild (2009) points out, elite interviews also indicate a person who is chosen by name or position for a particular reason, such as those who have specific knowledge or expertise, rather than selecting respondents randomly or anonymously. It also can be argued that elite interviews interact with key respondents who are involved directly or indirectly in the policy-making process, whose opinion carries weight and who are reliable, such as prominent academicians, former or retired politicians, bureaucrats, or heads of corporations. Most research methodologists point out that the interview is a superior method for data gathering especially with elites. This is because the researcher does not just access information and worldviews on policy making, but also the elite's gestures, facial expressions, tone of voice and emotions, which can provide insightful meaning and explanation (Bryman, 2001; Leedy and Ormord, 2005; Yin, 2003).

The sample selection in this research is based on purposive sampling (non-random), where respondents are chosen based on their special position or knowledge in policy making (Bruce, 2004). As a result, accessing and preparing to interview elites requires careful planning before starting the fieldwork. There are 25 elite interviews (further respondents' details in appendix) that have been conducted in the primary data collection. Most of these respondents were chosen based on their background, knowledge, expertise and experience in Malaysian economic policy. The elite interviews primarily include high-level position public officials, senior politicians, top political advisors, leaders of private enterprises, executive officers, heads of business associations, and prominent academicians. These selected respondents have mostly been involved in economic policy planning and implementation, particularly in relation to the national automotive policy. These respondents can be considered as having extensive experience and knowledge in formulating economic policy. Of particular note, due to limited financial resources, the fieldwork for collecting primary data was limited to three months. Most of the interviews lasted an average of 60 minutes. All respondents were asked to consent to allow their interview to be recorded (consent form is attached in the appendix). Most respondents gave their consent to record the conversation, though some preferred the conversation not to be recorded. This could be quite challenging because it was difficult to write down the data while interviewing. All interviews were undertaken at places and times convenient to each respondent.

In general, getting access to all of the respondents was based on formal appointments made by letters, emails and phone calls. Gaining access to the respondents was a challenging task, as some respondents agreed to participate in the interviews, while others have declined. Some informants agreed to be interviewed but they tended to use delay tactics and eventually did not respond to any phone calls or emails. Despite the challenges of getting access to elites, as a member of an academic staff myself, working in the public university in Malaysia (also considered as a civil servant), this position helped me to get in touch with key informants in the research. I also sought assistance from colleagues and close friends to obtain access to the respondents through 'informal' links to get appointments. Using informal links is also a tedious task because it requires 'creative thinking' to obtain close connections with certain elites before being able to interview them. This provided me access points to some key policymakers. A referral sampling (snowball) technique was also used to expand my primary data collections (Burnham et al*.,* 2008). To obtain interviews with key policymakers can be difficult at times, so as an alternative strategy, I also included local researchers (some who are consultants to the government in policy planning) who are accessible and have produced scholarly works on the Malaysian political economy. Some retirees, for instance former politicians and business leaders, are also included as respondents since they have specific knowledge on the automotive issues.

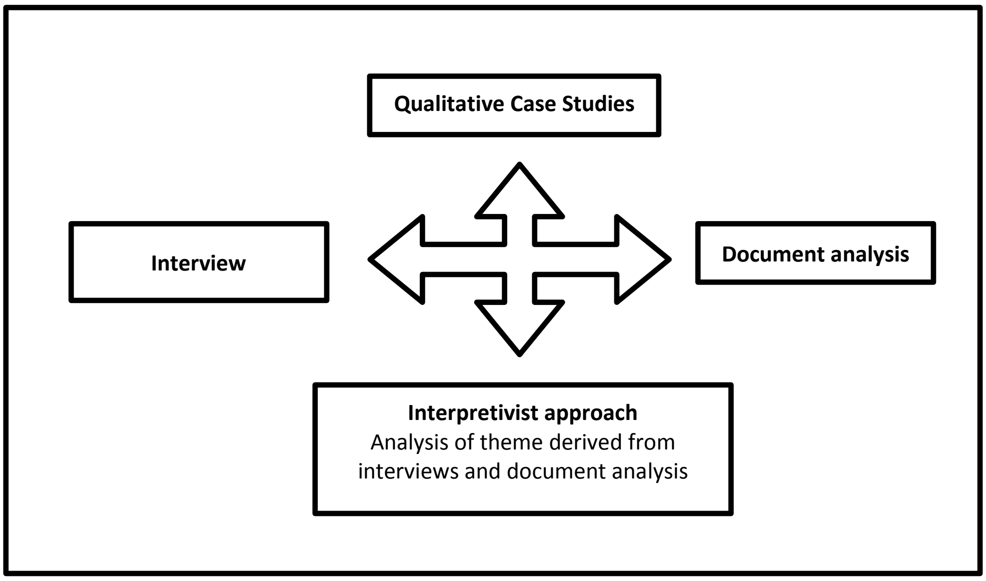
Semi-structured interviews were employed for the primary data collection. This technique lies in the researcher's responsibility to set topics or issues for the interview in light of the theoretical framework, while leaving room for open-ended questions for the interviewee to add further details during the interview process (Fontana and Frey, 1994). This technique is somewhat structured so the researcher can focus on relevant questions linked to the research theme (Mason, 1996), but its fluid and flexible structure also allows for the respondent to fully explain their experiences in the policy-making process. The epistemological stance of qualitative interviews (like semi-structured or unstructured interviews) recognises that the researcher and interviewee are working together in co-constructing data (Merriam, 2009). The technique emphasises on the respondents' perspectives that are bound to specific contexts, while the meaning or understanding of a policy-making reality is through interactions (Mason, 1996). Given that semi-structured interviews provide room for flexibility, this gives the researcher the opportunity to probe into detailed issues related to the political economy of economic policy processes. Semi-structured interviews also allow the respondents to construct their own account of experiences and opinions related to the national automotive policy.

Though semi-structure interviews are employed in the data collection process, during the interview some modifications were made to the questions. There are additional questions that were asked, and some were omitted, depending on the responses received from key informants. Some questions had to be avoided to keep their interest in the conversation. Additional questions were asked during the interview process, which is inevitable because issues of the information are best addressed within the session. There were also some variations in the questions, depending on who the interviewee was. For example, among others, specific questions were asked to private sector actors about their involvement in policy making, including how their interest is being represented and how informal linkages matter to advance their interests. For bureaucrats, more questions focused on policy issues, policy priorities and their role in the policy-making process, while for politicians the focus of questions was based more on the policy ideas, industrial development, ethno-development, and conflicting interests in pursuing policy preferences, etc.

Having been born in and having lived and worked in the country has given me first-hand knowledge of the culture and the taken-for-granted norms in Malaysia. This was crucial to being able to start a conversation with an elite and make them feel comfortable during the interview. During the qualitative interviewing, I have been very cautious with sensitive questions because at times interviewees could be reluctant to answer questions or feel the need to be politically correct. Qualitative interviewing enabled me to judge through non-verbal signs whether respondents were open to sensitive questions or interested in the research question. I tended to pay serious attention to any non-verbal signs that may permit me to ask some politically sensitive questions as well. Some respondents were open to explaining their policy-making experiences and describing how arrangements have been made between politicians and private enterprises. Others were more likely to answer with politically correct statements or at times to appear apathetic in the interviews. Some respondents could also skilfully derail from the topics and avoid sensitive questions by adding or shifting to a different topic in the conversation. It goes without saying that in elite interviews, respondents tend to face inevitable power relation issues (Harvey, 2011). For example, at times I found it difficult to ask important questions with the key elites when they exercised their superiority over me and ignored my question entirely by adding a new or unrelated topic to the conversation.
The overall strategy of data collection is used to make sense of the political reality of the policy-making process in Malaysia. This enabled to proceed with the subsequent stage of data analysis, which

requires transcription, careful reading, and interpreting the text. The data gathered and analysed are used to label themes emerging from the data collection that cognate with the theoretical lenses.

Table*:* 3.0 **Data collection strategy**



3.3 Data Analysis

This research uses an interpretivist approach for data analysis and interpretation. The key to the interpretivist approach is to understand motives, reasons and other subjective experiences (Edirisingha, 2012; Neuman, 2000; Hudson and Ozanne, 1988). It attempts to understand the phenomenon of interest from human actions and assertions. This is crucial because human beings make sense of their subjective reality and attach meaning to it. Pertinent to this regard is that the story, narration, language used, actions and behaviours are shaped by the institutions they are embedded in. In this sense, there is a need to access to the actors' shared meaning and consciousness in analysing political activities in policy making, because their lived experiences reflect the institutional context—including embedded norms, power relations and historical events which constitute the worldviews of policy actors (Bevir and Rhodes, 2015).

This research employed an interpretive inductive process to analyse data drawing from the elite interviews and documentary analysis. Following the interpretivist and inductive method, analysis of the case study is to identify patterns and series of events as well as to confirm and disconfirm the theoretical construct emerging from the qualitative inquiry (Yin, 2009). So the integrated theoretical lens which draws upon theories of institutionalism and a developmentalist state approach is used to guide and make sense of the politics of industrial policy process in Malaysia (as discussed in chapter 2). Bryman and Burgess (1994), Mitchell (2014), Merriam (2009), Creswell (2014), and Silverman (2009) suggest that researchers can have a pre-defined theoretical assumption or pre-set theme, which is first coded based on reviewing the literature prior to the data collection process. The researcher can then identify whether specific themes or concepts occur in the data. There is a need for careful observation to identify and recognise relationships between the theme derived from the research literature and empirical data obtained from the primary and secondary sources. Data derived from both sources were used to refine and expand the theoretical lenses. The iterative process, going back and forth between the data and theory is common in qualitative research whereby social scientists analyse data and thereafter adjust the theoretical constructs by linking empirical data (Jaccard and Jacobby, 2010; Eisenhardt, 1989).

The data analysis process began with transcription and was done soon after each interview was conducted. This enabled to reflect on the conversation with the respondents and not to miss out on the meanings expressed during the interaction. I transcribed all the elite interviews responses into a database and kept track of the questions asked of each respondent. The transcription process required careful listening to gain understanding of the language used, emotion, and behaviour. All data from the interviews and the secondary sources are used in the interactive process, which enabled me to trace and describe all forms of institutional arrangements made by economic actors in configuring Malaysia's national automotive policy. The analysis then proceeded with the coding technique. Coding is used to analyse and interpret the 'raw' primary data resources. In general, the coding technique refers to how data is extracted to be labelled or to construct themes. More specifically, coding is a process to link observations, statements, connecting themes and patterns from the data (Creswell, 2014). It is a systematic path for the researcher to familiarise with the research materials by building up interpretation (Crang, 2005). Pertinent in coding is that it 'opens up' text to uncover respondent's ideas and the meaning they hold (Given, 2005).

The interpretation of the analysis requires constant and careful reading of the transcribed text. The researcher needs to be immersed in the data through re-reading the text to identify words, ideas, themes and patterns (usually after the coding process) of the respondents, relating to institutional arrangements made for the national automotive policy within Malaysian institutional settings. This is crucial to make an interpretation of what has been said by the respondents about how they construct meaning and preferences in policy formations (Tansey, 2007). Leveraging on interpretivist qualitative interviewing, the main concern of human interaction is not to judge the 'objective truth[17]'. Instead, the main purpose is to understand the subjectivity of politics in the policy-making process from the elite's realm of knowledge and experience (Morris, 2009). Thus, the interview data will not be taken literally; rather, the researcher seeks to understand the respondent's viewpoint from their beliefs, purposes and preferences in constructing meaning and story (Sarantakos, 2005). Here, I was constantly going back to the original responses of the respondents to get an in-depth understanding of what they think and believe, including their values, attitudes and how they come to decisions within their institutional context in relation to the politics of policy process in Malaysia. After reading the transcripts several times, the sentences and themes being marked which are related to the topic.

The primary data collected demonstrated that the respondents in this study were well versed in their areas and provided deep knowledge about the policy-making process in Malaysia. The process of 'making sense of meaning' of the politics of policy-making reality within the role of institutions also derived from my interaction with the respondents, as Silverman (2001) and Edward and Holland (2013) point out that it is inevitable in a qualitative interview that the researcher co-constructs the social reality because the researcher him/herself is the instrument of collecting data. Therefore, the researcher-respondent interaction of making sense of meaning of the policy-making process is part of the valuable insights of the research.

From the qualitative data analysis this research aims to understand the role of institutions in the policy-making process and the politics behind the process. It also aims to gain a deep understanding of the elites' purposes, goals and values in the policy-making process. At the same time, a goal of the research is to highlight the interaction between elites in Malaysia's policy-making institutions. I generate descriptions of the institutional arrangements of Malaysia's national automotive policy and highlight some implicit aspects of political actions taken by elites.

3.4 Conclusion

[17] Morris (2009) points out that elite interviews are not so much about knowing the truth of a particular event. Qualitative interview approach deal with human interaction which is placing emphasis on the development of meaning rather than judging the truth through interview process (Bailey and Tilley, 2002).

In short, the methodology underpinning this research adopts a single case study on Malaysia's national automotive policy. The research intends to gain a deep understanding of the policy-making reality through a qualitative approach. A single case study can elicit context-specific issues, values, power relations and norms related to the key economic actors involved in policy process. The methods employed, such as secondary data and primary data collection, can explore and trace the institutional arrangements made by respondents evolving around the national automotive policy. The theoretical constructs and empirical analysis derived from the qualitative data analysis generate descriptions of the politics of Malaysia's policy-making process.

Chapter 4

The Development of the Malaysian Automotive Industry

4.0 Introduction

Like most developing countries, Malaysia has sought to industrialise. Industrialisation is key to modernise the economy and pursue a faster economic growth. Like most late industrialising countries, the state plays a strategic role in helping to steer industrial development. In particular, it plays this role in Malaysia, which has adopted a developmentalist state approach in industrialising the country. In this sense, the state has a paternalistic role in formulating policy, setting agenda and directing industrial development. Given such a policy-making environment, the policy formulation is dominated by the governing elites (politicians, state bureaucrats and 'selected' industrial groups). The industrial development is based on the constellation of the governing elite's interests. As part of modernising the economy, in the 1980s the government introduced a heavy industrialisation programme. The overriding objective of the programme was to foster backward and forward linkages, develop indigenous technological capabilities, diversify industrial structures and, more importantly, to modernise manufacturing activities. The heavy industrialisation programme is in line with the Look East Policy, which was inspired by the Northeast Asian industrial development.

One of the aims of the heavy industrialisation programme was to strengthen and enhance the automotive industry. Considering that the automotive sector links to various other industrial sectors (for example steel, electronics, plastics, etc.), the government sees the automotive industry as one of the central thrusts to spur the industrialisation process. In 1982, the government announced a national car project under the longest serving Prime Minister, Mahathir Mohammad, despite having little experience in that sector. The national car project is one of the most ambitious plans ever introduced by a leader from a developing country in Southeast Asia. The national car project was a turning point for industrial policy, as it was another round of import-substitute strategies in pursuit of 'a national champion'. Since the national car project was launched there has been a shift of state resources to facilitate the growth of the industry. Various institutional arrangements have been made to ensure the national carmakers are able to grow in the market. Policies were introduced as part of the protective measure to shield national carmakers against foreign automakers at the expense of the country's economic welfare. Also, in Malaysian political economy, ethnicity is an important political discourse for the political elites in configuring policy interest. Therefore, the national car project is embedded along with ethnic consideration, whereby it is part of increasing Bumiputra participation in the commercial and industrial sector.

This chapter will examine the development of the Malaysian automotive industry. The first section will provide an overview of the Malaysian automotive industry and its performance. This is followed by a historical assessment of the Malaysian automotive industry, which also establishes the background of the development of automotive industry. From the historical assessment, the chapter will proceed to explore the significance of the heavy industrialisation programme that gave birth to the national car project. It is an ambitious project that marked the state's adoption of a developmentalist state approach in pursuit of 'national champion'. Lastly, a discussion will be provided on the protectionist measures (tariff and non-tariff barriers) formed by the state to protect the domestic automotive industry despite the lacklustre performance of the local automakers and the vendors programme.

4.1 Overview of Malaysia's Automotive Industry

Malaysia has made defining watershed progress from a primary commodity dominated economy to an industrially based economy (Jomo and Wee, 2014). The automotive sector has been and remains one of the most important industries for the government to spur industrial development (Jomo, 1994; Torii, 1991; Rasiah and Jomo, 1999; Rasiah, 1997, 2007; Jayansakaran, 1994; Lim, 1994, 1984a, 1984b; Rosli, 2006; Abdulsomad 2003; Doner, 1991a, 1991b; Athokorala, 2014). It is an important growth driver for industrialisation because the automotive industry involves complex products, with more than 3,000 parts and components that involve different production processes and considerable specialisation (Abdulsomad, 2003). The industry has wide industrial (direct and indirect) linkages with primary, secondary and service sectors. Given that the industry has the potential to drive industrialisation from its linkages and spillover effect on other sectors (Dicken, 2007), the government sees the automotive industry as having strong relationships with economic development, generating employment, technological advancement and the hastening of the industrialisation process, hence improving the standard of living of the country. To date, the automotive industry has become one of the main key engines of growth for manufacturing in Malaysia. The industry has contributed RM49 billion (USD11.09 billion) or 4.2% to the national GDP (MAA, 2015). Malaysia has positioned itself as an important hub for car manufacturing and production of parts and components in the Southeast Asia region as well as globally (Rosli, 2006; Rosli and Kari, 2008).

In the last decade, global automotive production recorded a significant increase of over 40 per cent, from 58.4 million in 2000 to 90.7 million in 2014. Previously, the share for world vehicle production was mainly dominated by developed countries such as the USA, Germany, and Japan. However, recent statistics show that there has been a shift of global automotive production to late industrialising countries such as China, India, Mexico and Brazil that has increased their global share in vehicle productions. In 2014, the ASEAN region contributed 4.3 per cent of the global automotive production (AAF, 2015). Among the ASEAN members, Thailand has become an important hub for global vehicle production, as it expanded the volume of vehicle production from 0.3 million units in 2000 to 1.9 million units in 2015, and has increased its global share to 2.1%. Indonesia recorded an upward trend in vehicle production from 0.29 million units in 2000 to 1.09 million units in 2015. In the case of Malaysia, the total number of vehicle production doubled for the past decade, up from 0.28 million units in 2000 to 0.61 million units in 2015. In 2015, Malaysia ranked 23rd among the world automotive producing countries, while Thailand and Indonesia are ranked within the world's top 20 producers. Thailand, which is deemed to be the 'Detroit of Asia', ranked 12th while Indonesia moved up from 25th in 2000 to 17th in 2015 (see figure 4.0 for the complete table of rankings).

Figure 4.0 **Number of Vehicle Production**

Rank in 2015	Country	No. of Vehicles in 2015	Share in World Market 2015	Rank in 2000	No. of Vehicles in 2000	Share in World Market 2000
1	China	24,503,326	26.9%	8	2,069,069	3.5%
2	USA	12,100,095	13.3%	1	12,799,875	21.9%
3	Japan	9,278,238	10.2%	2	10,140,796	17.4%
4	Germany	6,033,164	6.6%	3	5,526,615	9.5%
5	South Korea	4,555,957	5%	5	3,114,998	5.3%
6	India	4,125,744	4.5%	15	801,360	1.4%
7	Mexico	3,565,469	3.9%	9	1,935,527	3.3%
8	Spain	2,733,201	3%	6	3,032,874	5.2%
9	Brazil	2,429,463	2.6%	12	1,681,517	2.9%
10	Canada	2,283,474	2.5%	7	2,961,636	5.1%
11	France	1,970,000	2.1%	4	3,348,361	5.7%
12	Thailand	1,915,420	2.1%	19	325,888	0.7%
13	UK	1,682,156	1.8%	10	1,813,894	3.1%
17	Indonesia	1,098,780	1.2%	25	292,710	0.5%
23	Malaysia	614,664	0.6%	26	282,830	0.5%

Note: number vehicle is referred to total production
Source: Data compiled from OICA (Organisation Internationale des Constructeurs d'Automobiles) and Natsuda, *et al* (2013)

In Malaysia, there are 18 licensed motor vehicle assembly plants and manufacturers in operation. The number consists of motor vehicle manufacturers and assembling companies, including franchise holders who have the rights to assemble[18] (Wad and Govindaraju, 2011; Natsuda et al., 2013). There are over 690 vendors producing more than 5,000 components in Malaysia (Otsuka and Natsuda, 2015). According to Natsuda et al. (2013), within Malaysia's overall vehicle production 70 percent of vendors are local or have local majority ownerships, while the other 30 percent are foreign or have a foreign majority ownership. These vendors supply two markets—the sell original parts and components to Original Equipment Manufacturers (OEMs) like Toyota, Honda, BMW, etc., and within the replacement equipment market, they sell items bought by repair shops and individual customers (Wad and Govindaraju, 2011).

The automotive industry has generated more than 48,000 jobs in the manufacturing of car and automotive parts. The industry has shown a 4.8% annual average growth rate for the past decades (Department of Statistic Malaysia, 2015). Proton, a national car producer, and Perodua, partly

[18] Proton, Proton Tanjung Malim, Perodua, Assembly Service (Toyota), Honda Malaysia, Tan Chong Motor Assembly, Plant 1&2 (Nissan), Swedish Motor Assembly (Volvo), Hicom Automotive Manufacturers (Suzuki, Mercedes, Volkswagen, Fuso), Isuzu Hicom Malaysia, Inokom (BMW, Ford, HD5000, Hyundai, Landrover, Mazda, Mini, Foton, Jinbei), Naza Automotive Manufacturing (Kia, Peugot Citroen), Scania Malaysia, Oriental Assemblers (Chery, Hyundai) and Kinabalu Motor Assembly (see Natsuda *et al*, 2012; Malaysia Automotive Association, 2015)

nationally owned, accounted for the largest workforce with nearly 70% of the total employment within the automotive industry (Wad and Govindaraju, 2011). However, according to the Malaysia Automotive Institute, it is estimated that the industry as a whole (including other manufacturing and service sectors that are linked directly and indirectly to the motor vehicles sector) provides more than 550,000 jobs for the country (MAI, 2015). This is parallel to the studies conducted by Turnbulls et al. (1992), Smitka (1991), Mutoh (1988) and Wells and Rawlinson (1994) that found that the automotive industry in countries such as America, Europe and Japan have the capacity to expand employment.

Over the years, the production capacity for motor vehicles in Malaysia has grown to 900,000 units in 2015. Although this is less than Thailand, which is estimated to be more than 2 million units (Thailand Automotive Institute, 2015), such capacity is sufficient enough to attract investors and maintain the automotive industry as one of Malaysia's key engines of economic growth. Although foreign investments in the automotive industry have tapered off, especially after the recent Great Recession in 2008, domestic investment remains high in the industry (MAA, 2015). In 2015, domestic investment for the automotive industry amounted to 0.97 million while foreign investment recorded 0.46 million (MAI, 2016; MAA, 2016). Despite low foreign investment, the regional production network within ASEAN countries has helped sustain investment in automotive production activities. This is the reason exports for motor vehicles, motorcycles, components and parts have remained high for the past few years (see figure 4.1).

Figure 4.1 **Export of Motor Vehicle, Motorcycles, Components and Parts**

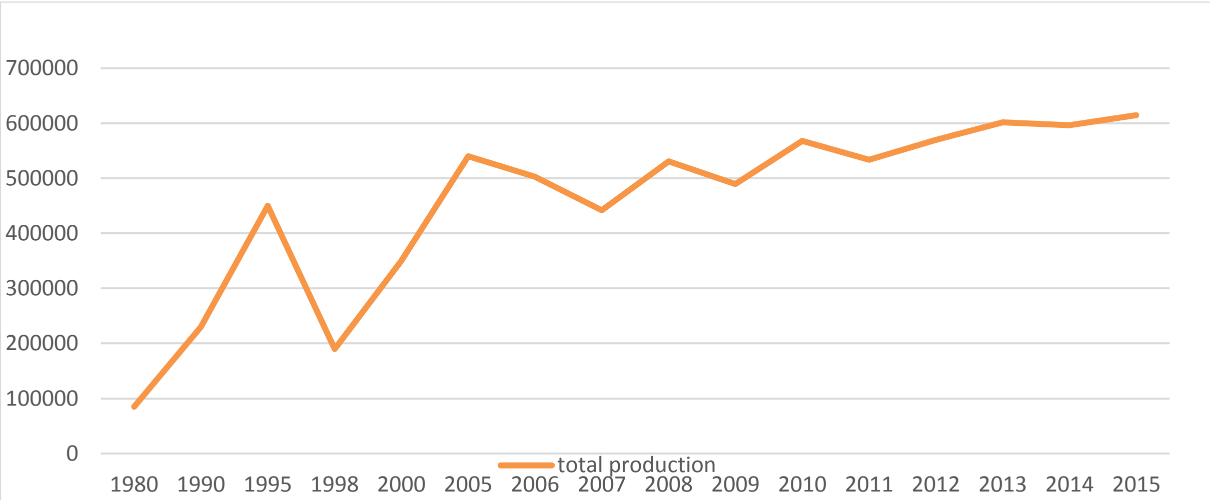
Exports	2013 (RM million)	2014 (RM million)	2015 (RM million)
Motor Vehicles	806.1	1,366.5	1,269.5
Motorcycles	8.1	25.6	38.9
Components and Parts	4,390.6	4,745.5	5,391.4
Total	5,204.8	6,137.9	6,699.8

Source: Department of Statistic Malaysia 2016

As Malaysia started to focus on developing the automotive industry at the end of the 1960s, the total number of vehicles produced did not surpass 100,000 units. The economic crisis in the 1980s further slowed the production of automobiles in the manufacturing sector. During the crisis, automotive production went as low as 85,000 units for both passenger and commercial vehicles. However, after the economy started to recover in the late 1980s, the total production increased significantly in 1991, whereby the automobile production reached more than 200,000 units. The growth of the industry gained its momentum in the early 1990s, compounded by strong economic growth especially after the

Plaza Accord agreement, where there was a considerable amount of foreign investments inflow (particularly from Northeast Asia, Japan and South Korea) to Malaysia (Abdulsomad, 1999; Jomo et al., 1997; Athukorala, 2010). The strong growth pushed the demand for automobile production to its highest peak for the first time in history with more than 450,000 units. However, the high production of vehicles came to a halt during the Asian Financial Crisis (AFC) in late 1997. The crisis resulted in contraction of fiscal policy and repatriation of foreign investments that led to a slowdown in the production of both passenger and commercial vehicles. After the AFC, vehicle production started to catch up again by early 2000, when the number of production increased consistently to reach more than 500,000 units, achieving its highest peak of 666,614 units in 2015 (see figure 4.2).

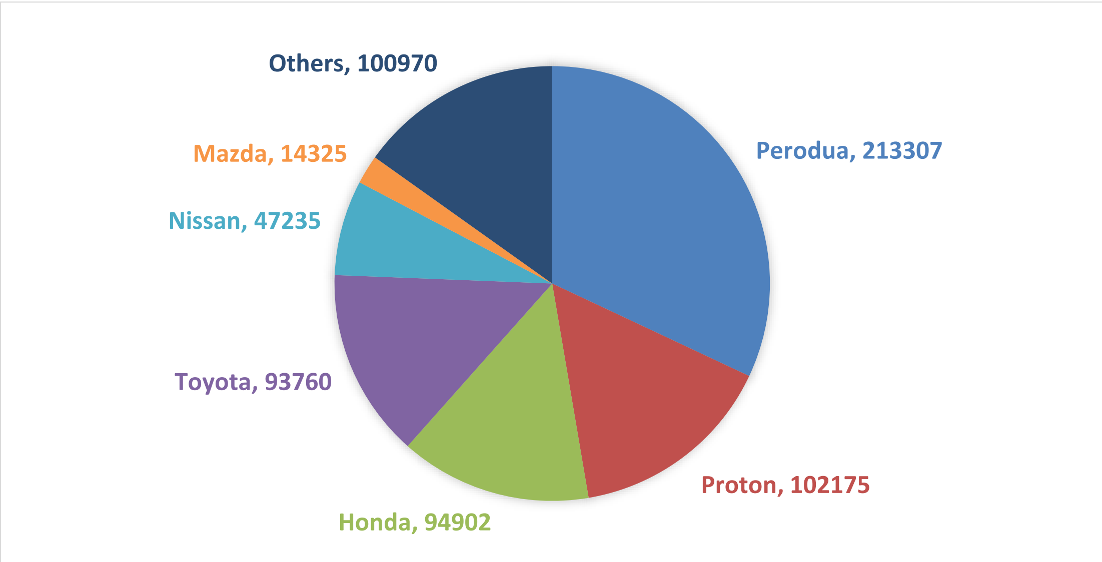
Figure 4.2 **Total Production of Vehicle in Malaysia 1980 – 2016**



Source: MAA, 2015

The largest producers in the automotive market are the 'national' car manufacturers Perodua and Proton. Perodua dominated the market with 213,307 units in 2015 and a domestic market share of 32 per cent. Proton is the second largest producer in the market, with 102,175 units and a total market share of 15.3 per cent. Other non-national producers that have similar market share are Honda and Toyota with around 14 per cent of Malaysia's market, which accounted for 94,902 units and 93,760 units, respectively, in 2015 (see figure 4.3). An important feature of car manufacturing in Malaysia is that the demand for passenger vehicles is very high, accounting for 563,883 of market share units, while commercial vehicles accounted for 50,781 units in 2015. This is different from neighbouring countries like Thailand, where passenger vehicles recorded 39.76 per cent (760,688 units) of the market share as compared to commercial vehicles at 60.24 percent (1,152,314 units) in the same year. In general, Malaysia has the largest passenger car market in the ASEAN region (MAA, 2015). The considerable demand for passenger cars mainly comes from middle-income earners and is mostly supplied by Perodua and Proton, which dominate the market share (Rosli, 2006; Natsuda et al., 2013). Overall, the automotive industry is central to the country's industrial development. Apart from generating employment, providing technological development and being a stimulus to other direct and indirect linkages, the industry has contributed a substantial amount of government revenue, accounting for RM7.0 billion from the excise duties and RM740 million from import duties in 2015 (MAA, 2016). The government attempts to ensure that the industry remains competitive to further spur industrialisation in the country.

Figure 4.3 **Production Share of Automotive Producers in Malaysia 2015**



Source: MAA, 2016

4.2 Development of the Automotive Industry in Malaysia

The development of the Malaysian automotive industry began in the 1960s. The country adopted an import substitute industrialisation (ISI) strategy in automotive industries to spur industrialisation. Given the complex production in automotive assembly, it hoped that the industry would enhance and diversify domestic manufacturing sectors such plastics, electronics, glass, steel and other metals, which could be linked up to the automotive production network. At the same time, foreign automakers were expected to contribute to the domestic economy in terms of technology advancement, skill development, and training and creation of small and medium enterprises (Abdulsomad, 1999, p.274).

The government started to promote automotive assembly. Though there were some existing local car assemblers, mainly Chinese companies linked to foreign automakers, the government did not build on these existing local assemblers. Instead of promoting the growth of the existing local companies, due to political considerations the government intended to use the automotive industry to foster Bumiputra commercial and industrial groups (Jesudason, 1989). This part of the ethno-development was spelled out in NEP, which has been a central tenant in Malaysia's political economy of industrial development. Since ethno-development precedes economic reasoning, the government facilitated the Bumiputra groups to participate in the automotive industry. With the involvement of the state in heavy industrialisation, formation and implementation of industrial policy is political (Ibid, p.274). Pertinent to Malaysia's political economy in the automotive industry is that the political elites see that various production processes involved in the automobile manufacturing sector can facilitate the participation of certain groups in industrial activities. The state can provide preferential treatment to foster the group in the sector through protections. It can also transfer resources (subsidies or grants) to the group so they can grow in the market. In relation to Malaysian political economy, the automobile sector is a strategic industry that can weave the overarching objective of the National Development Policy (NDP), which embodies the central tenet of the New Economic Policy (NEP). That tenet is to increase Bumiputra's participation in the commercial and industrial sector, improve equity ownership, foster entrepreneurs and generate employment. Therefore, it can address inequality of income distribution across other races (Torii, 1991).

The expansion of the Malaysian automotive industry has taken place through different phases of industrial development with different policy initiatives. From 1967–1982, the state started with an import-substituting automotive assembly industry as part of strengthening Malaysia's industrial base (Abdulsomad, 1999 p.277). From 1983–2003, the state began an ambitious project by establishing the national car project, which was a collaboration with Japanese automakers. Lastly, the government attempted to make Proton an independent national automobile industry from 2004 onwards (Wad and Govindaraju, 2011). At the outset, the first phase of industrialisation strategy during the 1960s emphasised import substitute industrialisation. The strategy also promoted automobile assembly activities while lifting protection for local assemblers (Lim and Onn, 1983; Jomo, 1994; Jayasankaran, 1994). This was done to encourage foreign automakers to relocate their assembling activities for passenger and commercial motor vehicles to the country. The import substitution industrialisation for the automotive industry aimed to promote the use of local parts and components, save foreign exchange and create employment. Support for the auto components manufacturing industry was considered to be crucial to enhance the overall industrial development (Jayasankaran, 1994; Jomo, 1994). Localisation policy (or local content policy) backed by heavy government tariffs was deemed to be an important policy instrument for import substitute industrialisation (Abdulsomad, 1999). In 1964, the government came out with local content policy to promote vehicle assembly and localised components for automobile (Torii, 1991). The localisation policy provided opportunities for the local assemblers (mainly Chinese) to be linked up with foreign car companies as part of spurring the local automotive industry. Local content policy was not adopted merely by Malaysia but by most Southeast Asian countries, namely Thailand, Indonesia and the Philippines, that engaged in the automotive industry as part of import substitute industrialisation (Doner et al., 2004).

The purpose of localisation is to increase the growth of local component production and the manufacturing industry. The policy is associated with the state playing a strategic role to facilitate linking local assemblers with foreign automakers. Import restriction is imposed through manufacturing licenses, approving permits, and special incentives (grant and subsidies) that are given to local assemblers (Jomo, 1994; Abdulsomad, 1999). As such, the state can push towards more dynamic activities in the domestic automotive sector at a faster rate than the market can achieve (Natsuda and Thoburn, 2014). It can also foster 'learning by doing' to acquire skills for the local assemblers, so that they can increase their skills and move up in the automotive production chain. To this end, the government started to promote the imports for completely knocked-down (CKDs) items while restricting the imports of completely built units (CBUs). The restriction entails a complex import process, high import duty and quantitative restriction for CBUs. The Motor Vehicles Assemblers Committee, founded by the Ministry of International Trade and Industry, also controls the auto dealer license that requires all companies engaging in import of CBUs to renew their licenses twice a year (Jayasakanran, 1993). With the introduction of automobile assembly activities, Malaysia started to engage in the engineering of industrialisation in the automotive sector (Lim and Onn, 1983).

In 1967, the first assembly plant, Swedish Motor Assemblies (a joint collaboration with Volvo) started to operate in Malaysia. Thereafter, the government approved six other assembly plants to start operations in Malaysia. In the same year, the government passed the Investment Incentive Act to encourage more assembly car manufacturers to use local parts (Tai and Ku, 2013). The policy at that time was to build linkages with foreign car manufacturers mainly from Europe and Japan. Subsequently, the Japanese car manufacturing companies dominated the Malaysian car assembly sector (Doner, 1991b). By the end of 1970s there were 11 assembly plants in Malaysia which produced 122 models of 25 makes of passenger cars and commercial vehicles (Athukorala, 2014). Companies involved in the car-assembly activities were Fiat, Mitsubishi, Chrysler, Volvo, Honda, Peugeot, Mercedes Benz, Toyota, Daihatsu, Fords, Land Rover and Citroen (ibid, p.4). Most of these foreign car companies engaged in assembly activities through equity and technical linkages with Malaysian local parts and components manufacturers who were mainly Chinese, and a small number who were Bumiputra (Jayasankaran, 1994; Jomo; 1983; Athukorala, 2014). Many of these firms began manufacturing replacement parts and intended to expand into the original equipment market (OEM) to supply local assemblers. However, the problem with the localisation policy was that different manufacturers and cars needed various components, so the local manufacturers were unable to engage in mass production of parts and components. It was difficult for the local manufacturers to achieve economies of scales, hence did not give them price advantage (Tai and Ku, 2013).

The government tried to increase the local content in the industry because of the low domestic local content assembled in the country. In the 1970s, local content was less than 10 per cent due to limited skills in the auto industry (Athukorala, 2014). Most assembling processes focused on low-tier assembling functions such as installing tyres, batteries, dashboards, paint, filters, seat-belts and glass items. As an attempt to incorporate further localisation in the auto industry, the government implemented a mandatory local content increase starting from 10 percent in 1972 to 35 per cent in 1982, and protection for parts producers (Lim and Onn, 1983). The increase of local content was based on the Walker Report[19] in 1970 that recommended an expansion of local content to 40 per cent over the next ten years (Lim and Onn 1983). The localisation policy was also in line with the New Economic Policy of 1970, which intended to increase Bumiputra participation in economic development. The localisation policy was to provide business opportunity for Bumiputra to partake in the auto industry, as previously there was little presence in the sector.

However, the first attempt to further increase the localisation program came with resistance from foreign investors. First, the cost of locally assembled parts was high because there was limited supply for components and parts available in the country. Most of the parts had to be imported from abroad, which increased the cost due to import duties. Second, the foreign companies, especially the Japanese, resisted compliance with the localisation program because the same price charged in Malaysia and Japan for the parts and components deleted in CKDs (Chan, 1988). The localisation

[19] The Walker Report of 1970 revised the previous Arthur D. Little Report in 1967 that suggested that local content should be limited to 20 per cent. Walker recommended that localisation should be increased to 40 per cent, as increasing the percentage of the localisation program would stimulate development of the automobile components industry and generate employment. Local content is calculated on a weight basis, i.e. net weight of Malaysian content in a vehicle expressed as a percentage of the assessed weight of the vehicle. Lastly, the report also suggests that any manufacturer who failed to meet the required local content target would be liable to pay a penalty, being a percentage of the vehicle's value.

program had little effect in the auto industry because of the abovementioned reasons. However, after the Malaysia Automotive Component Parts and Manufacturing Association was formed (representing more than 50 auto parts producers and, to date, more than 100 producers) (Jayansakaran, 1994; Chan, 1988; Natsuda et al., 2013), it managed to strengthen the localisation program.

In 1979, the government announced a mandatory deletion program (MDP) for CKDs. This program involved prohibition of some components in the CKDs from the approval lists, depending on local availability as agreed upon by foreign and local assemblers. The mandatory deletion program was supported by a strong protective measure for local producers such as incentives, tariff protections for parts producers and duty exemptions. The policy created market opportunity for local parts producers as well as for the Bumiputra community who were involved in the auto industry. The policy increased the local content level—there were approximately 200 parts and components producers and the level increased to 20 percent in 1980s (Chan, 1988; Lim and Onn, 1983). Later, the government adopted the Local Material Content Policy (LCMP) in 1992 that required an increase of local content between 45 to 60 percent (later it was phased out after Malaysia committed to WTO rules for liberalisation in the automotive industry in 2002 and onwards).

Despite increasing local content after the policy was implemented, in the context of NEP where the policy intended to increase Bumiputra participation in the sectors it made little contribution. In 1984, Bumiputra equity in the auto assembly sector was no more than 30 per cent, while Chinese equity was about 42.9 percent (Lim, 1994). Local producers for parts and components remained weak among the Bumiputra community. To further increase the participation of Bumiputra in the auto industry, the government introduced Approved Permits (AP)[20]. The AP is one of the most controversial permits introduced by the government, it being an import quota permit for imported luxury and used CBUs. There are two types of AP: Franchise and Open AP. The Franchise APs are given to franchise holders of a foreign automobile brands registered with the Ministry of International Trade and Industry (MITI) (MITI, 2016). The requirement for Franchise AP is that the company has to form a joint venture with Bumiputra companies in order to import motor vehicles into the Malaysian market[21].

[20] The total number of APs issued each year is capped at 10 per cent of the number of local-assembled cars in the preceding year, where 60 per cent of APs are allocated for Bumiputera Open AP holders and 40 per cent for franchise holders (MITI, 2016).

[21] For a company to qualify for franchise AP the equity requirement is 70 per cent Bumiputra and 30 per cent foreign company (MITI, 2015). For companies that do not have Bumiputra equity, they can purchase AP from an affiliated company. For instance, Mercedes Benz obtains import permits from NZ Wheel Sdn Bhd and Volkswagen appointed DRB-HICOM as dealer.

The Open AP gives the right to import used luxury cars exclusively to Bumiputra. This AP has increased the Bumiputra equity in the auto industry. However, it caused the rise of the 'Ali Baba arrangement'[22], where certain Bumiputra abused the permit to gain quick money by becoming a 'sleeping partner' in the company without doing the business. The AP also creates economic rents that strengthen the patron-client network between the political elites and the Bumiputra business community who intend to obtain access to the permits. Such rent may not necessarily yield new economic capabilities for the Bumiputra community because it does not really promote learning or innovation among those who obtain the permits (Hasan and Jomo, 2007). Furthermore, it increases political elites' influence to grant the permits to certain Bumiputra individuals who have close political connections. This type of economic rent created in the automotive industry is likely to transfer to non-productive groups. While Open AP may have negative implications in the auto industry, there are Bumiputra that become competent entrepreneurs in the automobile industry through the import quota (Hasan and Jomo, 2007). For instance, the Naza Group is one of the largest Bumiputra companies in auto assembly and dealing.

4.3 Industrial Nationalism: The Heavy Industrialisation Programme and Birth of National Car Projects

Under the tenure of Prime Minister Dr. Mahathir Mohammad, aggressive industrial policy is spelled out as part of the government's strategy to modernise the economy through industrialisation (Menon, 2008). Mahathir's leadership is a turning point for Malaysia's economic orientation and industrial policy strategy. The government strategy during the 1980s also attempted to address the problem associated with the strategy of local content during the early period of promoting the automotive industry. The localisation policy has a limited spinoff effect for the domestic automotive industry because domestic manufacturers are restricted to small medium enterprises in mid or low tier functions, such as assembly and subcontracting. Linkages built on the foreign automakers are limited, thus leading to a weak technological base and very shallow industrial specialisation (Embong, 1996; Menon, 2008; Tan, 2014; Kanapahty, 2001).

[22] This is a practice of joint collaboration between Bumiputra and Chinese individuals. Usually, the Bumiputra uses his privilege to obtain licenses for AP and sells it to the Chinese businessman who has capital to run the business (Whah, 2012).

To address this problem, the government launched the heavy industrialisation programme. The plan of heavy industrialisation is in line with the 'Look East Policy',[23] an industrialisation strategy that emphasises the role of the state to facilitate domestic firms in industrial deepening and upgrading, including in Northeast Asian countries such as Japan and South Korea (Lall, 2000; Jomo and Wee, 2014). Unlike Northeast Asia's (particularly South Korea and Japan) automotive industry that benefited industrially during the Japanese occupation, Malaysia does not have a strong industrial base for the automotive industry (Abdulsomad, 1999; Machado, 1994). The heavy industrialisation plan requires a 'big push' from the state because it needs a substantial amount of investment to embark on the program at the outset. There is a need for the state to facilitate building the industrial development capacity (Embong, 1996). Based on a developmentalist state approach premise, direct state involvement is necessary to facilitate the automotive industry because private firms lack initial capital to venture into heavy industrial development. The state acts as an entrepreneur to start up the considerable amount of capital investments to facilitate the growth of heavy industry (Kanapathy, 2001). As such, state sponsored industrialisation can overcome private investors' problems when considering high cost and risk in the industry that has a long gestation period (Alavi, 1999; Athukorala, 2014; Tai and Ku, 2013). The heavy Industrialisation programme has shifted the state resources, which initially Malaysia had limited comparative advantage (Mehmet, 1999). Jomo (2008) describes the heavy industry as 'albatrosses in the Malaysian economy' cause heavy burden on the government resources. Shortly after the announcement of the heavy industrialisation plan, the government came out with its first Industrial Master Plan (IMP 1986 – 1995), which envisaged that the automotive industry would lead in self-development mode with the formation of the national car project (Tai and Ku, 2013; Doner, 1992; Abdulsomad, 1999).

The state involvement in the heavy industrialisation program is also seen as way to attain ethnic redistribution and to reduce economic inequality across races (Jomo 1993; Gomez and Jomo, 1997; Embong, 1996, 2012; Tan, 2008). The automotive industry is deemed to be one of the strategic

[23] In this policy, announced by Prime Minister Mahathir Mohammad, the industrial development strategy is modelled along Northeast Asia's (Japan, South Korea and Taiwan) industrialisation strategy. The Northeast Asian governments employed the developmentalist state approach, 'where the government provides protection, credit allocation and subsidies, FDI restrictions, and skills and technology support to induce domestic firms to enter difficult activities, raise local content and take on advanced technological functions' (Lall, 2000 p.6). Here there is emphasis on industrial policy that facilitates the growth of certain segments of the industrial sectors (Chang, 2003). 'Matters deserving attention in the Look East Policy are diligence and discipline of work, loyalty to the nation and to the enterprises or business where a worker is employed, priority of group over individual interest, emphasis on productivity with high quality, upgrading efficiency, narrowing differentials and gaps between executives and workers, management systems which concentrated on long-term achievement not solely on increasing dividends or staff income in the short-term, and other factors that can contribute to progress of the country' (Mahathir, 1983 cited in Rasiah, 2011a, p.97).

industries that involves various production processes and specialisation that the state can link to the domestic firms in the industry with protectionist measures. The heavy industrialisation plan through the national car project can increase participation of the Bumiputra community in the auto industry at different levels of production. Furthermore, there are additional spin-offs for the community to seize such as managerial positions, engineers and technical experts. Basically, the long-term plan is to foster Bumiputra not just to be ordinary assemblers but as engineers that can design their own vehicle. By emphasising the focus on Bumiputra to be incorporated in the automobile business, it is an attempt by the state to 'bypass' those competent existing vendors (mainly Chinese) (Jomo, 2007).

Mahathir set up the Heavy Industries Corporation Malaysia (HICOM), a state-owned enterprise (later privatised in 1990s) that focuses on developing main industries such as petrochemical, iron and steel, cement, paper products, machinery, and transport equipment (Tan, 2014). The main objective of HICOM is to lead the heavy industrialisation programme by building and strengthening the foundation of manufacturing sectors by providing forward and backward linkages for the development of heavy industries (Menon, 2008). This is also to enable the transfer of knowledge to domestic enterprises in order to be competent in industrial activities. The government fashioned the programme with economic nationalism, in which the domestic firms (particularly led by Bumiputra groups) should lead industrial development with less dependence on foreign companies (Embong, 1996). The heavy industrialisation project resulted in high import quota, import duties and excise duties to protect the growth of strategic industries, including the automotive industry. This project also emphasises the interest to create wealth among selected groups in the society, particularly Bumiputra industrialist groups (Tan, 2014).

In 1983 Perusahan Otomobile Sendirian Berhad, or simply Proton, was launched as the first national car project. The establishment of the national car project was a joint venture between HICOM and the Mitsubishi Motor Corporation (Rosli, 2006). HICOM held 70 per cent of the share in the company and Mitsubishi Motor Corporation (MMC) had the remaining 30 per cent (Jomo, 1994). HICOM became the main shareholder through a RM33 million loan arranged by Mitsubishi. Jayansakaran (1993) observes that the deal with MMC led by Mahathir was done in almost total secrecy and there is dearth of information about the project available to the public. The national car project was also carried out without the cabinet approval at the outset. Furthermore, Mahathir did not make any attempt to open the options to other foreign firms for competitive bidding. By all accounts, the Prime Minister believed that MMC was the best Japanese automaker in the aspect of building national ambition (ibid, p.276).

The objective of producing the national car was mainly for the domestic market at the outset (later for export). This is in contrast to neighbouring countries, particularly Thailand, where the strategy is opening up for Foreign Direct investment (FDIs) and Join Venture (JV) in order to be integrated in the global vehicle production network (Tham 2003; Natsuda and Thoburn, 2014). By pursuing the national car project, the government envisaged the ability to rationalise the automobile industry, promote related industry, enhance utilisation of locally-made components, encourage upgrading of technology, and improve economics of scale among local manufacturers that link to the national car production chain. Above all, the national car project required over 20,000 components and this could increase Bumiputra involvement as suppliers in the industry (Jomo, 2007; Anazawa, 1997; 2006; Torii, 1991). In 1983, the first Proton plant was built in the HICOM industrial estate and was designed to produce 80,000 car units. Its capacity was extended to 120,000 units in 1988. In 1985, Proton began with its first inaugural model, the Saga (1300cc and 1500cc engines), which was based on the Mitsubishi Lancer Model.

A few years after the launch of the national car, Malaysia suffered from the world economic crisis at the end of 1986. The world commodity slump was one of the worst crises the country suffered since the formation of Malaysia in 1963. The automobile industry was one of the sectors that was badly affected by the economic recessions. The economy became weak due to the balance of payment deficit caused by a massive depreciation of the Malaysian currency. This was compounded by a sharp increase of the yen after the Plaza Accord in 1985, which eventually led Proton to the huge burden of repaying the start-up loan in yen (Abdulsomad, 1999). Furthermore, to buy CKDs kits and auto parts from Japan, the steep appreciation of the yen increased Proton's cost of production. As a result, Proton recorded continuing losses from 1985 until 1988 (ibid, 279). However, it did not take long for the national car to bounce back in the market. After the recovery in 1989, Proton became a popular car in Malaysia and by 1995 the national car managed to capture 78.7 per cent of the domestic passenger car market and started exporting to 28 countries (Hasan and Jomo, 2007).

The agreement between Proton and Mitsubishi left a grey area relating to export for Proton cars (Machado, 1993). It was clear in the agreement that for five years Mitsubishi would help produce a car for the domestic market. The time for Proton to dominate the domestic market was faster than expected because of the tariffs imposed on other foreign automakers. After the commodity slumps in the late 1980s, the government realised that relying on the domestic market was not enough for Proton to increase sales. The export of the national car seemed pertinent in order to sustain Proton production and attain economies of scales (Jomo, 1994). However, Mitsubishi resisted facilitating the

Proton as an export because it would directly compete with Mitsubishi cars between the range of 1.3cc and 1.6cc produced in Japan and Thailand. Also, Mitsubishi felt reluctant because the Saga model had lower quality, being like a downgraded version of the Mitsubishi Lancer (Bartu, 1992).

However, after the economic crisis, Proton started to export abroad and made arrangements for marketing independently from Mitsubishi under the directive of Mahathir Mohammad (Jomo, 1993). The national carmaker signed an agreement with Mainland Investment, a car dealer in the UK, for the low-end car market in the country (Athukorala, 2014). Proton managed to compete with Lada from the Soviet Union and Zastava from Yugoslavia in this category in the UK. At that time, the Saga model had a price advantage because it qualified for free import duty to the UK under the Generalised Scheme of Preferences. By the 1990s, Proton managed to export over 10,000 units, but the national carmaker was unable to sustain in the long term, due to stiff competition from other Japanese and Korean cars with better images and quality (Jomo, 1994). In 1986, Proton intended to work with Bricklin Industries Inc. of New York, a car distributor in the US that had successfully imported a Yugoslavian car, the Yugo, to the US market. Working with Bricklin would give Proton a new milestone by gaining access to the lucrative US market. Although the US company intended to sell 100,000 units for Proton, the company failed to obtain technical approval from US authorities for the import of the Proton Saga model (ibid p.276).

As an attempt to diversify the automotive industry, in 1991 Prime Minister Mahathir announced the second national car project, Perusahana Otomobile Kedua, also known as Perodua. The project mainly focused on small cars that were not direct competition for Proton models. Basically, the second national car project began in order to create a new lower middle-class car market (Athukorala, 2014; Wad, 2009; Wad and Govindaraju, 2011). Perodua was established as a joint venture with Daihatsu Motor (associated with Toyota), and started its production of the 660cc capacity Kancil model (based on Daihatsu Mira). Like Proton, the second national car project received similar tariff concessions and other government supports. Perodua is considered as a national car despite the fact that the manufacturing subsidiaries are 51 percent equity controlled by Daihatsu Motor Co. and Mitsui & Co., and in effect the Japanese Daihatsu holds the majority share in the second 'national' car project (Rosli, 2006; Wad and Govindaraju, 2011). In 1995, the government introduced Modenas, a local motorcycle manufacturing joint venture with Japan's Kawasaki. In the same year, the government also established the Malaysia Truck and Bus company (MTB) with Japan's Isuzu, which focused on commercial vehicles. In 1997, INOKOM was set up to produce light commercial vehicles with joint investment by Sime Darby Malaysia and Hyundai Motor Company (Doner and Wad, 2014). With the introduction of several national car projects, they were expected to utilise the Proton vendor network and other local firms. In doing so, the vendors and other local firms could increase production and reduce the cost of parts and component procurement by achieving economies of scales.

The government became increasingly concerned with the partnership between Proton and Mitsubishi. The purpose of forging partnership with the Japanese company was to build Proton as an internationally competitive, self-sufficient car, not simply a vehicle stamped by Mitsubishi that continued to use their parts and components (Natsuda et al., 2013). The partnership did not achieve this end, as Mitsubishi resisted transferring technology and exporting the national car (Jomo, 1994; Athukorala, 2014). There was no clear technology transfer to the Proton because Mitsubishi also resisted using local vendors as parts and components suppliers. In practice, Proton just assembled the auto parts imported from Japan. Furthermore, Mitsubishi tended to provide outdated technology with high management fees and cost of auto parts imported from the Mitsubishi production network (Jomo, 1993; Machado, 1993). The intention of the joint venture was to build Proton as competitive vehicles for export. Focusing on the domestic market itself was not sufficient for the national car company to achieve economic of scales due to the small market, hence export was necessary.

By 2004, Mitsubishi was trying to sell its shares because the company suffered from bad sales performance in North America. At the same time, the national car company already acquired 64 per cent of the equity in Lotus Group International Ltd, a British automotive company. Later, in 2003, Proton became the main shareholder of Lotus Group. Mitsubishi sold its stake to Khazanah National, a government investment arm, and to Petronas, the national oil company (in 2012 they sold them back to DRB-HICOM). This earmarked Mitsubishi’s exit from the national car company and allowed Proton to become a fully Malaysian-owned company (see further analysis on the Proton in Chapter 6).

4.4 Protectionist Policy for National Carmakers

When the government introduced the national car project as part of the heavy industrialisation plan, the objectives were to strengthen the growth of the national automaker and at the same to increase Bumiputra participation in the automotive industry. To this end, there was strong support and protective measures from tariff and non-tariff barriers to other direct and indirect financial supports from the state to the national carmakers (Jomo, 2007; Abdulsomad, 1999). It is common for a state to adopt the developmentalist approach (Embong, 1996), by which tariff and non-tariff barriers are deemed as effective measures to promote dynamic industrial activities. The protective measure is to improve production, address the lack of skills and expand the domestic market (Rosli, 2006). In the 1980s and late 1990s, the government set a heavy tariff for automobile sectors. The Malaysian government imposed a tariff on CBUs passenger vehicles between 90 to 200 percent in 1982. In 1997, the Malaysian import tariff rose between 140 to 300 percent of the import tariff for CBUs car, particularly for foreign cars with engine capacities within the range of 1200cc and 1600cc. The import tariffs imposed by the government were higher than those in Thailand, which levied an 80 per cent tariff for CBUs in the same year. Thailand, after changing from an authoritarian military regime in the 1990s, significantly reduced import tariffs for both CBU and CKD. The state relaxed restrictions on imports and started building linkages with foreign car assemblers to promote an outward-oriented economy (Tai and Ku, 2013). In Malaysia, tariffs for CKDs kits and auto parts were set between the range 40-50 per cent, lower than those CBU tariffs. The obvious reason was to protect the local assemblers and encourage foreign automakers to use locally produced auto parts and kits.

The Malaysian government has set preferential treatment for the national carmakers. While a high tariff is imposed on CKDs for non-national cars, the government exempted 40 per cent import tariff for Proton in 1985 and the exemption remained in effect until the early 1990s (Segawa, et al., 2014). Later, the government set the tariff at only 13 per cent in 1992 (this included the second national carmaker, Perodua) until December 2003[24]. The national carmakers (Proton and Perodua) also enjoyed preferential treatment on excise duties. They were given a 50 per cent exemption from excise duties and other internal taxes, such as sales tax and road tax. With the protective measures and privileges given to the national carmakers, Proton and Perodua had a competitive edge in terms of price over other foreign automakers in the Malaysian domestic market. In general, the Proton car is 50 per cent lower than similar capacity cars produced by foreign car companies (Segawa et al., 2014) Furthermore, to ensure the national car has a strong market share in the domestic automobile industry, the government, through the Ministry of International Trade and Industry and its agency, the Malaysia Industrial Development Authority (MIDA), made arrangements (formally and informally) with other carmakers to limit the range of models that do not compete with Proton (Doner, 1992, pp. 110-111). The government also directed all its ministries to switch to Proton as the official government vehicles. There were also special treatments for those who purchased the national car, where low

[24] After 2005 all tariffs are set between 0 – 5 per cent for CKD under the Asean Free Trade Agreement (AFTA). Further discussion will be made on this in Chapter 5.

interest rates, road tax and subsidised automobile loans were given to civil servants (Abdulsomad, 1999; Jomo, 2007).

A non-tariff barrier is also used by the government to protect the domestic automotive sector. The Manufacturing Licensing (ML) is used to restrict imports on model and makes that do not constitute a direct challenge to the national carmakers, especially those non-national cars below 1800cc. As noted earlier, since the late 1960s the government introduced Approve Permit (AP) as an import quota, so most car dealers must apply for AP to import vehicles into the domestic market. The government used the AP as a quantitative restriction to limit the number of CBUs entering the domestic market during the early development of the automotive sectors (Mahidin and Kanageswary, 2004). To date, the AP is still used by the government but with minimal restriction, and the government agreed to phase out the franchise AP in 2020.

With strong support from the government, along with protective measures for the national carmakers, Proton (and later Perodua) manages to dominate the domestic automotive market. Pertinent to this regard is that, when the government introduced the first and second national car projects in 1985 and 1994, respectively, the WTO rules for most favoured nation had not been properly enforced. Under the General Agreement on Tariff and Trade (GATTS), there is a special consideration for infant industries by which the state can impose trade restrictions (both tariffs and quantitative restrictions) on a temporary basis, especially for a developing country (Michalopoulos, 2000, p.6). In the case of Malaysia, the national automotive sector is deemed an infant industry. In addition, despite Southeast Asia committing to AFTA in 1992, the liberalisation effort only commenced after member countries came out with the Common Effective Preferential Tariff (CEPT) provision in 2002. However, Malaysia obtained an exemption to delay opening its automotive industry until 2006 (full implementation of CEPT was enforced in 2010). Therefore, prior to the market-oriented policy reforms under AFTA and WTO, Proton managed to expand its total production from 8,607 units (11 percent of the market share) in 1985 to 44,732 units (47 percent of the market share) in 1988[25] (Abdulsomad, 1999). Prior to the Asian Financial Crisis in 1997, Proton's total production reached a peak of 235,936 units, while Perodua accounted for 63,225 units (Natsuda et al., 2013, p. 18). By the end of 2000, the national carmakers captured almost 90 per cent of the market share for passenger car vehicles in Malaysia, of which Proton held 63.4 per cent while Perodua held 29.2 per cent (Natsuda and Thorburn, 2014, p.427; Mahidin and Kanageswary, 2004, p.6; Athukorala, 2014, p.9). Since Mahathir Mohammad introduced Proton and Perodua, both the national automotive companies have dominated the market share, particularly for cars under 1600cc. They managed to weed out most Japanese companies like Toyota, Honda, Mazda and Mitsubishi, which had previously dominated the Malaysian automotive industry since 1985.

Most scholars, who have long observed industrial policy on the automotive sector such as Yoshimatsu (2002), Athukorala (2014), Segawa et al. (2014), and Natsuda and Thoburn (2014), point out that the national car may have achieved a minimum efficient scale of production, especially when Proton reached production of more than 200,000 units in the 1990s, in relation to the plant size. However, they argue that it is far below the scale of total production for most automotive multinationals. Scholars like Bowie (1991), Rasiah (2006, 2009; 2008), Jomo (1993; 2007), Athukorala (2014), and Salleh and Meyanathan (1993) argue that overemphasis on the domestic market is not enough for Proton to achieve economies of scale, despite achieving a minimum of scale production. Proton's lack of competitiveness has reduced its ability to increase exports. It has also caused Proton to be a high-cost producer who survives based on government supports, preferential treatment and special arrangements for capital injection into the company. Worst still, it has led to overcapacity when the government introduced the second plant for Proton that was designed for a 500,000-unit production capacity. On the other hand, Perodua, of which Daihatsu Motor Co. (associated with Toyota) has a majority share, remains competitive for cars under 1000cc and has attained a better minimum scale of production as compared to Proton (Athukorala, 2014; Segawa et al., 2014).

4.5 Localisation Policy and Vendor Development

During the early development of the automotive industry, most developing countries would adopt local content policy as part of protective measures for the local assemblers (Doner et al., 2004; Doner, 1992). In Southeast Asia, Malaysia, Thailand and Indonesia were the strong advocates for localisation policy during the formative years of the automotive industry (Doner, 1992; Abdulsomad, 1999). As noted in the early discussion on the Malaysian automotive industry, the government introduced two important localisation policies: the Mandatory Deletion Program in 1980 (MDP) and the Local Material Content Program (LMCP) in 1992. These policies are protective measures that set a minimum value of local parts and components that need to be sourced out to local suppliers (Rosli, 2006). The MDP proscribed from importing 30 parts and components listed under the program, while the LMCP required all automotive manufacturers to attain local content of up to 60 per cent for passenger vehicles less than 1850cc, and 45 per cent for passenger vehicles 1851cc–2850cc by 1996 (Tham, 2004b p. 55, see figure 4.4). The local content policy is applicable for both national car manufacturers and franchise approved permit holders of foreign automotive manufacturers (Alavi and Hasan, 2001).

Table 4.4 **Years of Mandatory Deletion Program**

Types of Vehicles	**1992**	**1993**	**1994**	**1995**	**1996**	**2002**
Passenger Vehicles < 1850cc	30%	40%	50%	55%	60%	All Local content policy abolished
Passenger Vehicles 1850cc – 2850cc	20%	30%	35%	40%	45%	
Passenger Vehicles > 2850cc	Mandatory deletion items only					
Commercial vehicles < 2500cc						
Commercial vehicles > 2500 cc						

Source: Tham, 2004

After the localisation policy was introduced, the level of locally produced parts and components increased steadily from 8 per cent in 1979 (before the national car project) to 30 per cent in 1986. The impact of the policy can be seen in Proton. The first national car project is crucial in the localisation program to increase the locally produced parts and components for Proton. This is also to foster the local vendors as automobile components suppliers (Machado, 1994; Abdulsomad, 1999 p. 291). By the end of 1985, Proton's local content was around 20 per cent, and the level of local content continued to increase from 40 per cent in 1987 to 70 per cent in 1989 (Meyanathan and Ismail, 1994). By 2002, local content constituted 80 per cent in Proton and 65 per cent in Perodua's passenger cars, whereas other passenger cars recorded 35 to 65 per cent (Rosli, 2006). The number of locally sourced auto parts and components for Proton increased from 228 in 1985 to 1,014 in 1990, and the locally produced parts increased significantly to 4,319 in 1998 (Alavi and Hasan, 2001; Segawa et al., 2014). Given the vast opportunity to engage in the national car supply chain, the number of vendors increased significantly from 17 in 1985 to 188 in 1998. By 2001, 350 vendors were created to supply parts and components in the automotive industry. For Perodua, there were 30 vendors in 2001 and the number increased to 135 in 2004. The large development of vendors in Malaysia under the localisation program mostly relied on national carmakers (Leutert and Sudhoff, 1999; Mahidin and Kanageswary, 2004).

The government localisation program is linked to foster the development of local vendors. Given the automotive industry's involvement in complex production and specialisation, the localisation program provides opportunities to create backward linkages[26], which can improve the growth of automotive

[26] Alavi and Hasan (2001) posit that local content policy can foster greater backward linkages between industries where it can expand the volume or value of products because (i) close proximity with suppliers makes

production and parts and components (Alavi and Hasan, 2001; Thoburn, 1973). Since the state plays strategic roles in facilitating the growth of the national car project in the market, this makes it easier for the state to make linkages and arrangements to expand the vendor development. In Malaysia, where the state pays special consideration to Bumiputra to increase their involvement in economic development, they remain in consonance with the NEP objective to increase Bumiputra equity in commercial activities. By having the national automotive industry, the political elites see it as a strategic sector where they can increase Bumiputra participation through vendor development. This is one of the political manoeuvres used to create Bumiputra commercial and industrial community in order to strengthen the political base support for the long serving UMNO-led BN coalition government (Gomez and Jomo, 1997; Gomez, 2012; 2016). Scholars like Jomo (1994), Rasiah (1997), Bowie (1991), Gomez (2012) and Abdulsomad (1999) point out that this is one of the problems for the state in developing the national automotive industry, because implementing ethnic-coloured policy can reduce the efficiency and competitiveness of the national car project. The state-led development of the national car project generates economic rents, but those rents may be given to inexperienced firms that are politically connected.

In 1988, the government introduced the Vendor Development Program (VDP) to create greater industrial linkages between small and medium enterprises (SME) and large firms. The VDP was expected to be an important program to complement the localisation policy and support national automotive industries. Under the VDP, the state guaranteed a market for products produced by vendors (Alavi and Hasan, 2001), hence Proton became the main anchor company for the program under the Proton Vendor Development Scheme (later this occurred with Perodua in 1994). While there are foreign firms participating in the program, the focus of the vendor development program is to foster Bumiputra small medium enterprise to be linked up in the national carmakers' supply chain (Sadoi 1998, Rosli and Kari, 2008). This is part government strategy to increase the number of Bumiputra in auto kits manufacturing activities. Since the introduction of VDP, a considerable amount of funds is allocated for the development program in Malaysia through five-year plans and the Industrial Master Plan (I, II and III). The government's emphasis on Bumiputra participation in the automotive industry has created an artificial monopoly (Tan, 2008) in the production of auto parts and components market for individual Bumiputra who are politically connected with the political elites.

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procurement cheaper, predictable, flexible and easier to negotiate and monitor, (ii) it is easier to provide technical information, product specification and material even when there is changes in production, (iii) there is lower risk of disruption of supplier, (iv) there is established trust and networking, (v) it can strengthen inter-firm relationships (p.37).

Under the VDP that emphasises Bumiputra development, Proton is obliged to procure auto components preferentially from Bumiputra vendors[27], despite the vendors having limited management and manufacturing experience. Proton employs a single sourcing system, meaning that only a single firm supplies a particular component. This system created rent, which intends to allow vendors to achieve economies of scales[28] and protect the vendors (Anazawa, 1997). The government also facilitates the local firms in 'match-making' to seek for partnerships with reputable foreign firms, in order to assist technology upgrading and skills development[29]. The partnership takes the form of joint-ventures, technical assistance programmes and purchase agreements. SMEs that are selected by the national carmaker are qualified to apply for a RM1 million grant from the government (Yoshimatsu, 2000). These grants are given to vendors for purchasing capital goods, intermediate inputs and acquiring technology fees. The government also provides RM22 million under the Ministry of International Trade and Industry to provide financial grants to Bumiputra SMEs in technological upgrading and manufacturing, including electroplating, tool-making and machining (Alavi and Hasan, 2001 p. 40; Abdulsomad, 1994). As a result, there is a rapid growth in the production of vehicles assembly and manufacturing in Malaysia. Demands for auto components have also increased. The Malaysia Industrial Development and Authority reported that there are about 300 firms in the auto parts, of which 70 per cent engage in OEM production (MIDA 1997). At the same time, the number of Bumiputra vendors increased significantly, from 4 in 1985 to 142 in 2005 (PVA, 2005).

The localisation policy works similarly to tariff protection. This enables the state to protect local vendors and promote the vendor development program. The VDP has recorded success in developing automotive parts and components for SMEs and stimulating skills and technological development (Leutert and Sudhoff, 1999). However, the state-led vendor development has also had adverse consequences on the national automotive industry. Since the development of the national automotive industry embedded with political agenda, the vendor program is less likely to 'pick up winners'; rather, it is driven by rent-seeking behaviour to obtain access to preferential treatment (Whah, 2012; Gomez and Jomo, 1997). Therefore, the state-led national automotive industry is unproductive because the rent is captured by inefficient producers (Rasiah, 1999), and it is difficult to replace those inefficient producers with productives one. Though the number of vendors increased over time, the firms linked to Proton failed to grow competitively. Leutart and Sudhoff (1999) point out that most local suppliers

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[27] A vendor is considered Bumiputra if the SME shareholder fund is less than 2.5 million, 70 per cent of the equity is held by Bumiputra, and 55 per cent of the employees are Bumiputra.

[28] It was replaced by multisourcing in 2000 and phased out in 2005, after Malaysia committed to AFTA economic liberalisation.

[29] According to Paramjit (n.d.) after the match-making programme initiated by Proton for its vendors, 56 per cent was with Japanese firms, 7 per cent each with German and Korea firms, and 5 per cent each with Taiwanese and French companies (cited in Alavi and Hasan, 2001 p.42).

are producing uneconomical scale, which leads to higher prices. The products of the auto kits tend to have inferior quality due to lack of quality control. The VDP has created fragmented industry structures with more than 300 firms producing different auto kits. Most of these firms are unable to achieve economies of scale that hinder technological upgrading. There is also lack of efficiency and international competitiveness. Most of the suppliers linked to the VDP are unable to export the automotive parts and accessories. In contrast, suppliers that are not linked to VDP started to export and equipped their production process with higher-level technology (Leutart and Sudhoff, 1999). Knowing that a single-sourced system caused inefficiency, the national carmaker started to move away from the system by selecting competitive vendors in the Proton production network (Tham, 2014). However, this does not mean that the national carmaker can easily do away with the patronage system, because some politically-connected individuals remain as vendors to the national carmaker.

4.6 Conclusion

The Malaysian automotive industry is one of the main segments of industrial development owing to the complex wide industrial linkages. Prior to the introduction of the national car project, there were many government initiatives to facilitate the growth of national automotive sectors, such as localisation policy and the controversial Approve Permits (AP). As part of diversifying the industrial structure of the automotive sector, the government introduced the national car projects despite lacking industrial expertise. By pursuing the national car project, the government was able to rationalise the automobile industry, promote related industry, enhance utilisation of locally-made components, encourage upgrading of technology, and also spur the industrialisation process. High tariff and non-tariff barriers were erected to protect the domestic automotive sector and national car projects. This was to enable national cars to grow in the marketplace, while at the same time restricting other auto companies' makes and models.

The political elite had also fashioned the national car project as a nationalist economic project in order to increase Bumiputra participation. This was inevitable, because the NEP has become a 'guiding principle' to incorporate the Bumiputra agenda. The direction of the national car projects and other policies associated with the development of the national automotive industry shows the capacity of ruling elite in modernising the automotive industry. This gives a paternalistic role to the ruling elites in the automotive market as they are able to provide preferential treatment to the local car companies and the vendor development programme. While dependence on state resources at the outset of industrial development is crucial for national carmakers and the vendor development programme, ongoing dependence on rents may have detrimental effects on the automotive sector. Furthermore, the lack of strict performance requirement left in place has led the local carmakers and other vendors to be less competitive.

The historical specificity of the development of automotive sectors may affect the growth of the automotive industry and the automotive policy. The dependence of national car and vendors on state rents to grow at the outset will not be easy to remove in the long run. Underpinned by the patron-client network, rent-seeking behaviour will continue, especially when the development of the automotive industry is linked to industrial nationalism and Bumiputra class interest.

Chapter 5

Trade Liberalisation and the Malaysian National Automotive Policy

5.0 Introduction

This chapter explores the liberalisation of Malaysia's automotive industry. It also provides discussion of the National Automotive Policy (NAP) of 2006, and its outcome, this policy is created as part of liberalisation initiatives by the government. Though the policy arrangement in NAP attempts to liberalise the automotive industry, there are protective measures to secure the interest of the domestic automotive industry. An important feature of the automotive industry in Malaysia, as one of the Association of Southeast Asian (ASEAN) member governments, is that it is the only country that produced its own national car. The presence of the national car project and label as a source of 'national pride' gives more leverage to the political elites to coordinate policy to protect the sector. Also, the project is an important part of developing the Bumiputra commercial and industrial community. The policymakers thus have strong influences on the institutional arrangements in the policy-making domain to secure the interests of the national car project and its vendors.

The growth of the automotive sector in Malaysia has been heavily backed by government tariffs due to the state's substantial interests. However, despite protective measures being crucial at the outset of the heavy industrialisation program, pro-market reforms are an inevitable process for Malaysia's automotive industry to be competitive. Increasing liberalisation pressure coming from international institutions like the WTO and trade agreement such the ASEAN Free Trade Agreement (AFTA) have pressured the government to open up the domestic automotive sectors. This is one of the industrial segments in Malaysia that is heavily protected due to the presence of the national auto project. The ruling elites faced a difficult situation. On one hand opening up the automotive industry could undermine the growth of the national carmaker, which has to compete with other competitive foreign automakers especially from Japanese companies. On the other hand, the state could not operate in a closed environment in order to engage in the automotive production network. Furthermore, the state wants to enjoy a wider market access, so it could not escape from the obligation of pro-market reforms under AFTA and WTO. In the end, the policy makers acquiesced to open up the automotive industry, and the government gradually started to liberalise the industry in the late 2000s.

In 2006 the government introduced the National Automotive Policy under the third industrial master plan. The policy advocates for transforming the local automotive industry, given the increasingly liberalised and competitive global environment. NAP intends to integrate the local automotive industry into the regional and global automotive production network and to enhance competitiveness (NAP, 2014, p.1). In short, the policy is seen as a pro-market reform for the domestic automotive market. However, the extent to which the government would initiate a wholesale liberalisation initiative is a much-debated question. Considering that governing elites can orchestrate the policy formation, this gives them considerable influence on policy making to secure the domestic automotive sectors. Despite the government's commitment to neo-liberal policy, the elite policy actors have the capacity to craft policy alternatives for protective measures in automotive sectors. The discussion of this chapter proceeds as follows. First, this chapter will explain the ASEAN automotive industry as an important hub for automotive production globally and as a key driver for trade in the ASEAN region. This includes discussion on the performance of the ASEAN automotive industry to provide background for Malaysia's position in the automotive sector in the region. The next section will examine the liberalisation pressure on Malaysia's automotive industry and responses from the government. Last, there is a discussion on the National Automotive Policy as a reaction to pressure from the trade liberalisation initiatives.

5.1 ASEAN Automotive Industry

The automotive production network in Southeast Asia started in the 1960s, when foreign companies from the US and Europe began to outsource their production to the region. Then followed by Northeast Asia especially Japan and South Korea, currently the Japanese companies have the dominant presence in Southeast Asia's automobile industry[30] (Frost and Sullivan, 2002; Tai, 2016; Doner and Wad, 2014). Foreign companies' investments in the region aim to produce components and vehicles for export in the regional and global networks (Donor et al., 2004). Having their multiple production plants in the region allows foreign companies, especially Japanese companies, to take

[30] The Japanese automaker controlled 88% of motor vehicle sales and 98% of production in Indonesia, and held Thailand's sales and production at 88% and 81% respectively, as well as 62% of sales and 81% of production in Malaysia (Doner and Wad, 2014, p.669; Wardauto, 2012; OICA, 2014).

advantage of its relatively good infrastructures, lax environmental restrictions, comparatively low production costs and relatively efficient labour (Doner, 1991b; Jenkins, 1987; Jomo, 1994; Standing, 1993). Especially during the formative years of the Southeast Asian industrialisation period, the region welcomed most of the foreign auto companies to their countries because it views the automobile industry as central to industrialisation and promoting economic growth (Donor, 2006; Donor and Wad, 2014).

Dicken (2007) points out that the automotive sector is the 'industry of the industries', as this sector has wide industrial spillover that can pull the rest of the economy. The automotive sector also has deep forward and backward linkages with various key segments of the economy, hence the industry has strong multiplying effects on the growth of developing countries, making it capable of becoming the driver of economic growth (Nag et al., 2007, p.4). The sector is not just able to generate employment and improve the balance of trade, it is also one of the most globalised industries today. Countries engaging in auto production can specialise in different levels of production in the global automotive network (Sturgeon et al., 2008; Gereffi, 1995; Coe et al., 2004). The automotive industry in Southeast Asia has transformed production profile, improved local value add and speed up industrial development (Bernard and Ravenhill, 1995; Achana, 2013).

Southeast Asian countries have become one of the important sites for global automotive companies due to the population in the region, consisting of more than 600 million people with youth forming major figures. The GDP growth was recorded at 2.4 trillion in 2013. Despite the region succumbing to the Asian Financial Crisis (AFC) in 1997 and the Great Recession in 2008, the countries in Southeast Asia have quickly returned to the recovery path (McKinsey & Co, 2014). This recovery was partly supported by the regional production network that can swiftly recoup from crisis and improve economic growth (Athukorala, 2010). This attracts various foreign auto companies into the region to establish their production base and take advantage of the cost-saving production in multiple sites in the region. Considering the potential growth of this region, the Southeast Asian countries (mainly refering to Thailand, Indonesia, Malaysia and the Philippines)[31] have recorded healthy growth for the past three decades (see table 5.0 and figure 5.1). The combined production of motor vehicles by these four major countries in ASEAN increased from 394,812 in 1980 to 2,980,361 in 2010, and the numbers of production continued to increase to 3,725,214 in 2015. For the past decade, the growth of automotive production increased almost 10 times in the region. Though the region has shown positive

[31] The Southeast Asian Countries Thailand, Indonesia, Malaysia and the Philippines are the main sites for automotive production in Southeast Asia; they are also known as the ASEAN-4.

growth in automotive production, each members' state in the Southeast Asian region has a different level of production, which is largely linked to the political economy orientation of the state, as it influences industrial policy in automotive sectors.

Table: 5.0 **ASEAN-4 motor vehicle production (in units)**

Country	1980	1995	2000	2010	2015	Average annual change (%) 2000 - 2015
Malaysia	104,227	288,338	284,600	567,715	614,664	7.7%
Thailand	73,985	525,680	325,888	1,644,4513	1,913,002	32%
Indonesia	174,700	388,000	292,710	702,508	1,098,780	18%
Philippines	41,900	127,016	41,840	65,625	98,768	9%
Total	**394,812**	**1,329034**	**945,038**	**2,980,361**	**3,725,214**	

Table 5.0a **ASEAN-4 motor vehicle sales (in units)**

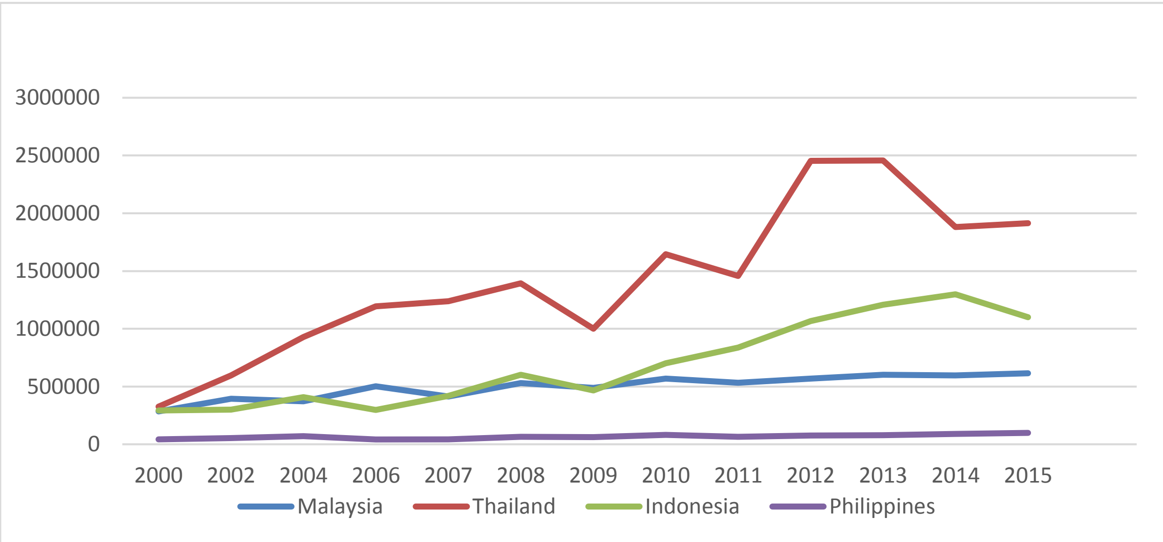
Country	1980	1995	2000	2010	2015	Average annual change (%) 2000 - 2015
Malaysia	97,262	285,795	343,173	605,156	666,674	6%
Thailand	89,201	547,758	262,109	800,357	799,632	13.6%
Indonesia	212000	384,000	309,514	764,710	1,013,291	15%
Philippines	70,000	128,162	84,132	168,490	288,609	16%
Total	**468,463**	**1,345,715**	**998,925**	**2,338,713**	**2,768,206**	

Source: Doner and Wad, 2014, Wad, 2009 MAA, 2015, AAF, 2015

After the Asian financial crisis, motor vehicle production steadily increased from 2000 onwards for the main major automotive producers in ASEAN (see figure 5.0a). Based on the total production in the ASEAN-4, Malaysia and the Philippines show a modest growth rate, although the average change for the Philippines is slightly higher than in Malaysia. However, in terms of total production, the Philippines does not show any significant improvement. Ofreneo (2008) points out that due to unclear automotive policy implementation, there are more second-hand car imports dominating the market and less attention given to domestic assembling in the Phillipines; hence the total number of production has stalled after reaching a peak of production in 2004 (Wad, 2009; p.175). Malaysia's sluggish growth rate is due to the state interest in protecting the national carmaker despite the state adopted market-based policy. Tremendous growth was recorded for Thailand and Indonesia, both countries having double-digit growth rates of 32% and 18%, respectively. In terms of total production, the number of motor vehicles manufactured in Thailand alone is more than the rest of the four countries combined. The main factor that increased the number of production in Thailand was not merely adopting a liberal industrial policy. Rather, the state also started to diversify its automotive production into commercial vehicles under the auspice of foreign OEMs, and transformed into global pickup production outside the US (Doner, 2009, see table 5.2).

By and large, domestic sales of automobiles are lower than the production of motor vehicles in the ASEAN-4. In Thailand, the export-oriented strategy made the country less dependent on the domestic market. As noted earlier, the Philippines recorded the highest growth rate in total sales in the region due to the considerable imports of CBUs. Among the ASEAN 4, Indonesia's annual growth rate is one of the highest, at 15 per cent. In fact, in 2015 its total sales were the highest in the region, recorded at 1,013,291. Malaysia's annual growth rate remained in single digits in domestic sales, due to a heavy excise duty tax on foreign cars imposed by the government to ensure the national carmakers can survive in the market (see figure 5.8).

Figure 5.1 **ASEAN-4 Motor Vehicle Production 2000 – 2015**



Source: ASEAN Automotive Federation, Wad, 2009

Table 5.2 ASEAN-4 passenger and commercial car production 2000 and 2015

Country	**2000**		**2015**	
	Passenger Car	**Commercial car**	**Passenger Car**	**Commercial car**
Malaysia	280,283	2,547	558,324	56,347
Thailand	97,129	314,592	772,250	1,143,170
Indonesia	257,058	35,652	824,445	274,335
Philippines	15,540	26,300	36,395	62,373

Source: OICA 2015, AAF, 2016

Most of the Southeast Asian members' state export has increased more rapidly than import in all ASEAN-4 in starting from a low industrial base in 1990 (see table 5.3). After the region integrated in automotive production, Thailand is the only country that recorded a positive export balance in automotive production since 2000, and their export doubled in number in the 2000s. In contrast to Malaysia, although the exports in automotive production have grown and surpassed imports in average annual growth rate, the country has a recorded negative trade balance. The trade deficit has increased from US$1.2 billion in 1990 to US$4.5 billion in 2010, and continued to record a deficit of $4.8 billion in 2015. For Indonesia, despite the country keeping pace over its exports, imports remained high in 2010, though auto production recorded a small trade deficit in 2015 as compared to 2010. The Philippines show moderate growth in exports, reaching the highest exports in 2010 with US$1.82 billion and a decline in exports in 2015. The country recorded a high import level in production, which, as stated earlier, is related to the heavy reliance on CBUs imports for the domestic market.

Table: 5.3 **ASEAN-4 World trade of automotive products by the ASEAN – 4, 1990 – 2015 (US$ billions, current prices)**

Country	**Trade**	**1990**	**1995**	**2000**	**2010**	**2015**
Malaysia	Export	0.12	0.28	0.31	1.33	1.51
	Import	1.31	2.79	1.83	5.76	6.31
Thailand	Export	0.11	0.49	2.42	18.70	26.67
	Import	2.65	5.18	2.08	8.54	8.34
Indonesia	Export	0.02	0.13	0.37	2.55	4.87
	Import	1.52	3.14	1.87	5.56	4.98
Philippines	Export	0.02	0.22	0.58	1.82	1.5
	Import	0.54	1.54	0.97	2.57	4.11

Source: WTO statistic database time series on 'automotive products' and Doner and Wad, 2014

The exports and imports of automotive commodities within the ASEAN region have increased over the past decades, from 1.06 billion exports in 2000 to 11.72 billion in 2015. The imports have also increased, from US$0.80 billion in 2000 to US$9.64 billion in 2016. The market-oriented reforms by the ASEAN have shown positive growth of automotive trade in the region. While intra-ASEAN recorded healthy growth of automotive trading, the exports of extra-ASEAN has increased significantly as compared to the imports of ASEAN from the outside world (see table 5.4). In fact, in 2015 the total exports surpassed the total imports of automotive commodities for the first time, which clearly indicates that regional competitiveness is on the rise after the 2000s.

Table: 5.4 **ASEAN automotive products for the period 2000 – 2015 (US$ billions)**

Automotive products	2000	2005	2010	2015	Annual average change % (2000 – 2015)
Intra- ASEAN					
Export	1.06	4.88	9.22	11.72	67.4
Import	0.80	3.98	8.33	9.46	72.6
Extra-ASEAN					
Export	3.33	9.10	19.13	26.92	47.6
Import	9.55	14.02	21.36	25.21	10.6

Source: WTO statistic database time series on 'automotive products' and Doner and Wad, 2014

5.2 Liberalisation of Automotive Industry

The Southeast Asian country members have undergone different phases of industrial development and strategies over the past decades. By and large, this region has initiated policy change in their trade regime to an open environment since the late 1990s. Political economist scholars point out that most changes in industrial policy are linked to change of regime, and most scholars who have long observed the industrial development of Southeast Asia argue that political economy of the state can affect the institutional arrangements on industrial development, which then have direct implications on the industrialisation strategy. It goes without saying that the influence of globalisation to push for an outward-oriented economy is also a driver for policy change (Doner, 2009; Haggard, 1998; Haggard and Low, 2000; Low, 2004; Jomo, 2004, 2001; Tai, 2015; Nelson, 2012). Thailand, under Chaichai Choonhave in 1988, and subsequently Anand Panyarachun in the early 1990s, liberalised the automotive industry and pushed an export-oriented economy under the auspice of foreign investment (Doner and Wad, 2014; Tai, 2016). When Thaksin's government took over the new industrial plan was announced in the early 21st century, which was to turn Thailand into the 'Detroit of Asia' (Busser, 2005 p.33). The Thai government came out with new policy by emphasising export performance and other industrial support for foreign automakers (Wad, 2009). In Indonesia, after the fall of Soeharto, his controversial national car programme (Mobil Nasional a.k.a MOBNAS) that was owned by his son was abandoned, a move that has opened up their automotive industry (Abbott, 2003; Hale, 2001). This was also part of a 'structural adjustment' under the International Monetary Fund (IMF), after Indonesia sought assistance to recover from the Asian financial crisis (Tai, 2016). In the Philippines, after the end of Marco's era, the government embarked on progressive liberalisation of its trade regime (Ofreno, 2015 p.6). According to Hill (2013), during the Ramos administration trade liberalization agendas were implemented vigorously, not only by completing tariff cuts also by the removal of many regulatory barriers to competition (p.120). Consequently, the government could not control the influx of imported used cars in the domestic market.

Malaysia is an exceptional country, being ruled by the same political party—the UMNO led BN—since the formation of the country in 1963. Given the longevity of the ruling coalition, there is a close relationship between the state and market, particularly in the automotive sector. Hill, Tham and Ragayah (2012) describe Malaysia's political economy on industrial policy reforms as 'sclerosis', referring to rigid institutions that maintain a grip on political power, resources and domestic class interest, while Doner and Wad (2014) observe that the government is an 'unwilling liberaliser'. The historical specificity has created a close reciprocal relationship between state and market because UMNO is seen as the political party responsible for industrial development. Given that there are reciprocal relationships between the state elites (politicians, bureaucrats) and Bumiputra business groups, industrial strategy tends to protect UMNO's interests (Chin, 2015; 2017). Since the government pursued a 'national champion product' with the national car project since 1985, the project is linked to the Prime Minister's interest and politically-linked industrial groups, hence any market-oriented policy reforms may undermine those interests. Although the Malaysian government has attempted to protect the national car project since it was introduced, the automotive sector has undergone changes since the 2000s. Pressure to change industrial policy has come from regional trade agreements (or other bilateral trade agreements) and commitments to international organisations, particularly the World Trade Organisation, which Malaysia has to comply with, the Most Favoured Nation tariff and national treatment policy principle (Tham 2014; Natsuda and Thorburn, 2015). This pressure, embedded with pro-market oriented policy reforms, has somehow pushed the government to liberalise the domestic automotive market, since the government has to commit to the neoliberal policy (to certain extent) in order to make a freer business environment. Consequently, restrictive policy regime protecting the national car project has to be revised to promote a level playing field market environment.

As a founding member of the Association of Southeast Asia Nations, (ASEAN), Malaysia, along with the major Association of Southeast Asia Nations (ASEAN) members, namely Thailand, Indonesia, the Philippines and Singapore (later joined by Vietnam in 2006, Lao and Myanmar in 2008 and Cambodia in 2010), agreed to sign the ASEAN Free Trade Agreement (AFTA) in 1992 (Athukorala, 2014). The overarching objective of AFTA was to form regional trade liberalisation in Southeast Asia by 2008 (later re-schedule to 2003). It was inspired by the Single European Market in 1992 and the North America Free Trade Agreement (NAFTA) in 1994, with initiating openness in the region being the key policy lever to ensure a competitive economy (Hill, 2013). Regional liberalisation is done to overcome the shortcoming in multilateral agreements in the WTO, especially for a developing country to negotiate terms of trade[32]. Regional trade liberalisation gives member states better ways to develop trade agreements between ASEAN member governments (Nesadurai, 2002). With the formation of AFTA, ASEAN member governments can position the region as a competitive base of production regionally and globally with their locational advantage. To this end, the ASEAN members come to collective agreements to promote intra-ASEAN trade and industrial linkages and specialisation, and to enhance economic efficiency, improve economies of scale and become a competitive production base for investment (ASEAN, 2015). AFTA can offer firms (local and foreign) greater access to a larger market and a wider base of resources in ASEAN countries.

This regional economic integration came out with a Common Effective Preferential Tariff (CEPT) provision in 2002. CEPT was introduced to help movement towards reducing existing tariffs and aimed to eliminate non-tariff barriers within ASEAN (Natsuda et al*.,* 2013). Members of AFTA agreed to reduce tariffs applicable to imports within the region on 8,764 tariff lines, to between 0 and 5 per cent. This was a major commitment made by the ASEAN members to liberalise the regional market. The global automakers operating in Southeast Asia expressed strong support on the regional liberalisation process. To facilitate negotiation between member countries and multinational automotive companies, the ASEAN Industrial Cooperation (AICO), a bilateral complementation scheme, launched in 1996. The AICO aims primarily to improve the auto industry in ASEAN countries with automakers in resource sharing pooling and industrial complementation (Doner 2006a).

However, the automobile industry is not an easy policy agenda to deal with in the trade agreement, especially for Malaysia. Although CEPT was introduced in 2002 to provide a freer business environment in the ASEAN region, the actual full implementation was effectively enforced from 2010 onwards. This was because the Malaysian government attempted to delay the automotive trade liberalisation. The main reason was because the state has considerable interest in protecting the national car and its local parts and components producers in the domestic market. In addition, the Malaysian government pointed out that after the Asian Financial Crisis the national automotive industry had not recovered and the industry was still in its infant stage and needed more time to compete in an open environment (Mahidin and Kanageswary, 2004). The state has also been able to protect the automotive industry because it is also linked to Bumiputra interest, which is still unable to

[32] This regionalist project enables member states to negotiate trade policy in more flexible manners and enhance cooperation between member states (Hurrell, 1995; Gamble and Payne, 1996)

compete in a level playing field (Tan, 2008). Bumiputra interest is essential in economic policy as part of meeting the ethno-economic development and social engineering (Gomez, 2012; Wad, 2009). This ability to delay reveals the institutional capacity of elite policymakers in the policy-making institutions to slow progressive liberalisation. The elite policy-makers have to maintain domestic interests in automotive sectors. Though liberalisation can offer greater market access, this may not be the best interest of the elite policy-makers because it can undermine the national carmaker and its vendors.

Given that state actors play a strategic role in the institutional arrangements to secure the domestic automotive sector, the government requested that AFTA obtain exclusion for automobile products in the CEPT tariff reductions. Malaysia registered automobiles and production of parts and components on the Temporary Exclusion List (TEL) because it believed that the domestic automobile industry may face difficulties in the open market economy. This extension was granted in AFTA, though the Malaysian government had to reduce the tariff lines between 0 and 5 percent by 2005 (Tham, 2003). In contrast, Thailand, Indonesia and the Philippines, had transferred automobiles to the Inclusion List in 2000 under CEPT. In particular, Thailand intended to hasten the regional liberalisation process (especially for the automotive industry) because of vast foreign direct investments inflow from Japanese and European carmakers into the country (Kohpaiboon, 2008; Donor, 2006b). Since the country promotes joint ventures between local assemblers and foreign carmakers to promote exports, liberalising at a quicker pace was to their advantage in the region.

Under CEPT, all ASEAN member governments agreed to effectively remove all tariff and non-tariff barriers in ASEAN countries that discriminate against automotive products that are considered 'Made in ASEAN' (Athukorala, 2014). CEPT results policy reforms for member states' trade policy, though for Malaysia such reforms potentially undermine the national interest, especially in automotive sectors. The pressure from AFTA to push for market reforms in the automotive industry seems inevitable for Malaysia. Commitment to trade liberalisation has made the government loosen some of its protective grip, as they had to make gradual tariff reductions and scale back quantitative imports restrictions in the automotive sector. The government made partial liberalisation manifest in the tariff reduction under CEPT in 2004, a year before the agreed deadline of 2005 (see table 5.5). Tariffs before liberalisation ranging from 70 to 190 per cent had been reduced to 20 per cent in 2005 for CBUs. Thereafter, they decreased to 5 per cent in 2006 and effectively cut to zero per cent in 2010. For CKDs, tariffs were removed in 2005. On the commitment to the WTO, under the Most Favoured Nation principle, tariffs initially set between 140 to 300 per cent had been cut to 50 per cent in 2005. Further reduction was made to 30 per cent for all MFN CBUs, while for CKDs, tariffs were drastically cut from between 42-80 per cent down to 10 percent.

Table: 5.5 **Tariffs on CBU**

Engine capacity (cc)	Before 1997	1997	2004	2005	2006	2010
MFN Passenger Vehicles						
< 1800	140%	140%	80%	50%	30%[33]	30%
≥ 1800 - < 2000	170%	170%	100%	50%	30%	30%
≥ 2000 - < 2500	170%	200%	120%	50%	30%	30%
≥ 2500 - ≤ 3000	200%	250%	160%	50%	30%	30%
> 3000	200%	300%	200%	30%	30%	30%
ASEAN (CEPT) Passenger Vehicles						
< 1800	-	-	70%	20%	5%	0%
≥ 1800 - < 2000	-	-	90%	20%	5%	0%
≥ 2000 - < 2500	-	-	110%	20%	5%	0%
≥ 2500 - ≤ 3000	-	-	150%	20%	5%	0%
> 3000	-	-	190%	20%	5%	0%

Table: 5.5a **Tariffs on CKD**

Engine capacity (cc)	Before 1997	1997	2004	2005	2006	2010
MFN Passenger Vehicles						
< 1800	42%	42%	35%	50%	10%	10%
≥ 1800 - < 2000	42%	42%	35%	50%	10%	10%
≥ 2000 - < 2500	42%	60%	35%	50%	10%	10%
≥ 2500 - ≤ 3000	42%	70%	35%	50%	10%	10%
> 3000	42%	80%	35%	20%	10%	10%
ASEAN (CEPT) Passenger Vehicles						
< 1800	-	-	25%	20%	0%	0%
≥ 1800 - < 2000	-	-	25%	20%	0%	0%
≥ 2000 - < 2500	-	-	25%	20%	0%	0%
≥ 2500 - ≤ 3000	-	-	25%	20%	0%	0%
> 3000	-	-	25%	20%	0%	0%

Source: Natsude *et al*, 2012; MAI, 2011; MAA, 2015

The market-oriented policy reforms have exposed the two national carmakers to competition from foreign automakers who have their production base in ASEAN countries, particularly in Thailand, the hub of most foreign automakers. The reforms also open up foreign carmakers, especially Japanese

[33] Malaysia applies the maximum tariff bound in WTO for automotive product

companies, to increase production on passenger cars, which potentially threatens the national carmaker's domestic market (Segawa et al., 2014). Prior to the trade liberalisation initiative, Proton managed to expand its total sales from 8,607 units in 1985 to reach a peak of 235,936 units in 1997. While Perodua also dominated the small size-car market segment with 63,225 units in 1997, the commendable growth in total number of sales for this second national car project, begun in 1994, was due to government support through tariffs. After the liberalisation process, the domestic market for the national car has changed drastically. Proton sales started to drop from 166,118 in 2005 to 115,538 in 2006. The combined market share of the two national carmakers declined from 92.7 per cent in 2000 to 57.2 per cent in 2010. The market share further shrank to 47.3 per cent in 2015 for both national car companies. Proton has lost the position as the top selling car in Malaysia's market after the pro-market reforms. In fact, Proton's total sales in the domestic market have rarely reached more than 200,000 units after 2000. This was further compounded by the Great Recession in 2008 that caused decline in the total market share of the national carmakers. In 2007, Proton recorded a loss of RM46.85 million (US$ 13.6 million) and increased to US$ 88.1 million (US$ 21.61 million) in 2011 (The Star, 2012; The Report, 2008). The government arranged to bail out the ailing local carmakers because Proton's loss affected the business of local vendors associated with Proton (The Edge, 2016). To date, Proton only manages to secure 15 per cent of the domestic market. The company is also unable to resolve the overcapacity in their production, given that Proton is unable to capture a wider market share. Furthermore, the poor exports performance of Proton accounted for 16,189 units in 2011, followed by 13,311 units in 2012 and only 5,937 in 2015 (Malay Mail, 2014). This exports performance of around less than 10 per cent of its total sales makes it unable to achieve economies of scales.

Perodua, the second national car project, is relatively resilient despite facing stiff competition from the international carmakers. This is partly because the company is managed by Daihatsu, which is associated with Toyota. Although there was a slight decline in terms of market share after the policy reforms, Perodua managed to maintain between 41.6 per cent in 2006 and 32 per cent in 2015. The second national car company tops the league for total sales in Malaysia's market after Proton. Although Perodua was able to capture the low-end of the car market, its exports performance is somehow better than Proton's but remains a suboptimal performance in the global market. Average export is between 10,000 units - 8,000 units, which is no more than 10 per cent of its total sales (Harman, 2016). After the trade liberalisation, other Japanese companies and the European car market started to increase in Malaysia's domestic market. Japanese companies like Toyota, Honda, Nissan have gradually increased their market share, and Toyota and Honda have managed to reach more than 10 per cent of it (Segawa et al., 2014). Previously, these auto carmakers were only able to capture less than 10 per cent of the domestic market share after the government imposed heavy tariffs in

1985. It is important to note that though the two national car projects may have lost market shares under open market competition, the national carmakers, especially Proton remains in the top three position in the overall market share in Malaysia (see figure 5.7, further explanation will be made in Chapter 7).

Figure 5.6 **Total Number of Sales for the National Carmakers**

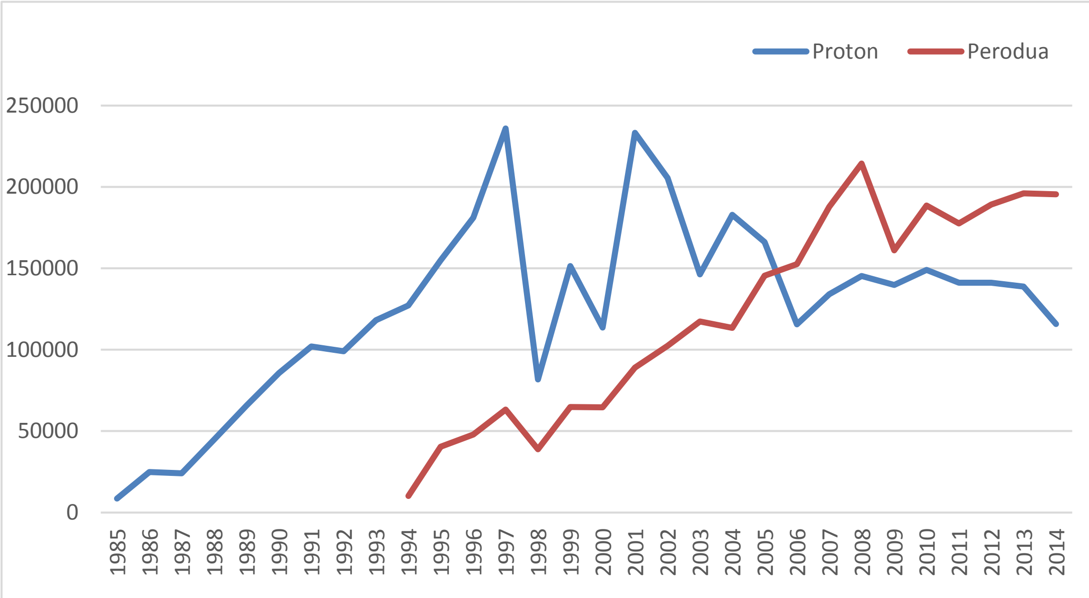
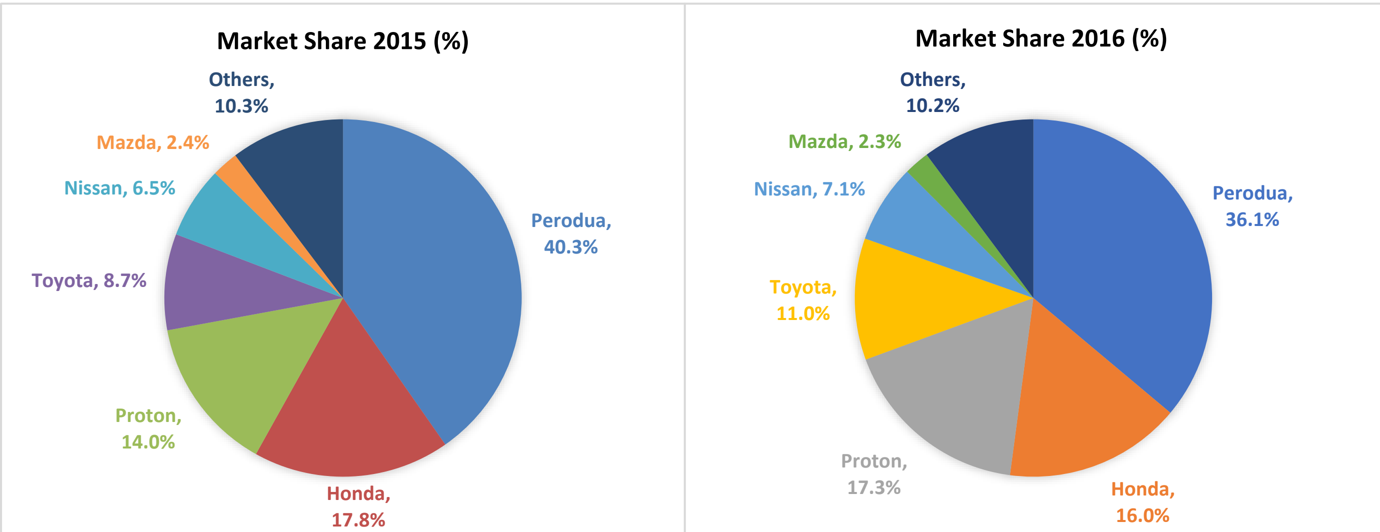


Figure 5.7 **Domestic Automotive Market Share 2015 and 2016 (%)**



Source: MAA, 2016; Paultan, 2016

As mentioned in the previous chapter, localisation policy introduced by the government is part of protective measures for local parts producers, especially in developing countries engaged in the automotive production network. The local content requirement imposed by developing countries is a contentious policy. The policy limits a freer business environment for foreign assemblers to operate in the host countries, which gives a greater role to the state to regulate the business environment. Some analysts are pessimistic about the role of the state in regulating the business environment (Wonnacott, 1995; Abrenica, 2000; Lee and Han, 2006) because local content policy may increase tariffs for imports of inputs in automotive sectors. This policy does not just distort the auto kits and components market but could also create high economic costs for consumers and a deficit in the government budget due to inefficiency and misallocation of resources linked to a high protection level.

The policy obstructs the free business environment, thus it can affect economic efficiency and opportunities for international companies with multiple production plants for automobile parts and components. Despite the negative effects, the localisation policy was established to foster the growth of automotive sectors in the host countries, especially in late industrialising countries (Amsden, 2001; Amsden and Hikino, 2000; Chang, 2003; Rasiah, 2005; 2006 Rodrick, 2004), mainly because the policy can hasten the industrialisation process by strengthening the local industrial base for automotive production (Bora et al., 2001). Despite critiques on the role of government in the market, late latecomers like South Korea (Amsden, 2001) employed a local content policy to ensure the growth of the automotive sectors as well. The local content policy can also act as a pro-competitive device to counteract the behaviour of foreign automakers who exploit domestic resources with less attention nurturing the growth of the domestic automotive industry. Local content is crucial for developing countries to develop automotive sectors in the formative years, though Malaysia, as a member of the WTO, was obliged to remove the policy by 2002 under the Trade Related Investment Measures (TRIMs).

Agreement on TRIMs was made after the Uruguay Round in 1994 and subsequently the establishment of the WTO (Tham, 2015). The agreement, referred to as a country investment policy, covers the conditions of investment relating to goods only. It acts as the core rules of the international trading regime by identifying measures of member governments that are not consistent with the national treatment, applying performance requirements (for instance it forces companies to use domestic inputs rather than imported inputs), and making quantitative restrictions (UNCTAD, 2006). Though the purpose of this agreement is to prevent the state from obstructing the free business environment, it does not restrict the host government from developing regulating measures for foreign companies.

The agreement does not cover measures relating to technological transfer and export performance. Governments can still demand foreign firms to transfer technology by specifying certain portions of R&D locally or providing licenses for local firms on specific technology. Also, the host government can influence firms' employment practices with the aim to develop human capital, skills and training (UNCTAD, 2006; Shadlen, 2005; Natsuda and Thodurn, 2014). In his analysis, Dunkley (1997) categorises TRIMs into to two types: 'positive,' for example when the state provides tax concessions to attract foreign investors, and 'negative', when governments can control foreign participation in certain sectors of the economy through the provision of tax incentives. This means that TRIMs provide options for a country to retain local content. The next sections describe Malaysia's institutional arrangements in NAP to craft policy options for local content (further analysis in Chapter 7).

It is an inevitable process for WTO member states to provide a market-based economy. It is obvious, though, that the localisation policy used by the Malaysian government (including other ASEAN member states) violates TRIMs requirements (Rasiah, 2005; Tham, 2004a). The local content policy limits business practices because it places obligations on foreign companies to procure locally made components and to limit the use of imported inputs. In short, the policy prevents a freer business environment for foreign companies in the host economy. Under the TRIMs agreement, WTO member governments were given a time schedule to eliminate all measures. While developed countries were expected to remove them by 1997, developing countries were given until 2000 to remove policy that contravenes TRIMs. Malaysia's government started to phase out the local content program after it applied for two extensions. In 2002, the government agreed to remove the local content policy under the Local Material Content Program (LMCP) and removed 11 products from the Mandatory Deleted Items (MDI) list. The remaining 19 items listed in the MDI were abolished in 2004[34] (Alavi and Hasan, 2001 p.35).

Phasing out the localisation policy means that there are more competitive foreign OEMs that can provide better quality auto parts and components in the market. Liberalising the auto parts and component sectors provide wider choices for assemblers to obtain auto kits without restrictions. This also opens up national automakers' options to seek multi-sourcing, hence increasing automotive product quality. However, the impact of the local content policy removal has adverse consequences for Malaysia's automotive industry (Rasiah, 2005; 1997) and local vendors (Rosli and Kari, 2008), especially for the Bumiputra vendors (Natsuda et al., 2014). While there are other efficient local

[34] While most Southeast Asian countries have removed local content policy but under AFTA member' states agreed to have tariff cut between 0 – 5 percent tariff. Nevertheless, it has to meet 40 percent local content requirement originating from participating ASEAN countries

vendors in Malaysia that are linked to foreign auto companies, most of the state-backed local vendors are supported by tariffs and subsidies. The local vendors rely heavily on the national carmakers. Most vendors have limited market base mainly confined within the domestic market and in the Proton or Perodua supply chain network. In his analysis on trade related investment, Rasiah (2005) points out that TRIMs have undermined the domestic auto parts and components market because, to a certain extent, local content aiming to facilitate the growth of the selective sector in the economy is necessary. This is parallel to Chang (2003), who argues that selective supports by the state are necessary to make industries build strong linkages and viable to grow (cited in Rasiah, 2005). Rasiah (2005) and Chang (2003) suggest that local content is important to facilitate learning, and governments divert resources to the sector to promote upgrading. Liberalisation can undermine the allocation of rents to promote learning, particularly in local content requirements. This may slow the capabilities of the automotive industry, which in turn can hamper upgrading (Rasiah, 2005 p.465). However, the economic rent will create suboptimal growth if captured by unproductive producers. In Malaysia, the ethnic-coloured policy is one of the factors that impedes the growth of competitive automotive producers (Khan, 2000; Tan, 2014; Rasiah, 2009; 2011b).

The government acquiesced to open up the automotive sector though liberalising the sector could threaten the national car project and local vendors in the domestic market. It could also undermine the growth of the national car to achieve economies of scale. The lacklustre export performance for both national carmakers do not contribute to the increase of total sales volume against the backdrop of the small domestic market. Similarly, the removal of local content policy could threaten the local vendors that are linked to Proton and Perodua. However, for the automotive industry to be competitive, the national car companies could not operate in a protective environment for a long period of time. This is because protective measures that lead to oligopolistic rents distort economic growth at the expense of consumer welfare (WTO, 1997), especially rents given to individuals with a strong political-cum-business interest under the rubric of national champion. It is necessary to open the domestic automotive market so that the national car companies would strive for better quality products, improve labour skills and create incentives for innovation in a level playing field environment (Rasiah, 1997; Tham, 2014).

5.3 National Automotive Policy (NAP)

After the liberalisation pressure, the government introduced the National Automotive Policy (NAP) in 2006 to promote the competitiveness of Malaysia's automotive industry. NAP is the main thrust in Malaysia's third Industrial Master Plan (IMP 3 2006–2020), a broad policy guidance formed under the Barisan Nasional government to achieve an 'industrialised nation' status in line with the country's 'Vision 2020', that is to make it a developed country (Li and Imm, 2007). Previously, there was no specific automotive policy. Previously the automotive industry was guided mainly by five year Malaysia plans, and the Industrial Master Plan I (1986 – 1995) and IMP II (1996–2006). After the liberalisation initiative, the government started to craft the national automotive policy as part of its response to the liberalisation pressure. NAP was introduced in 2006 with two revisions in 2009 and 2014. The overarching objective of NAP is to transform the domestic automotive industry and integrate it into the regional and global industry network, within the increasingly liberalised and competitive global environment (MITI, 2006). The policy also laid down six objectives to strengthen the national automotive industry: (i) to promote a competitive and sustainable domestic automotive industry, especially for national car manufacturers; (ii) to develop Malaysia as a regional automotive hub; (iii) to enhance value added and local capabilities in the industry; (iv) to promote the export of vehicles and automotive components; (v) to promote Bumiputra participation in the industry; and (vi) to safeguard consumer interests by offering safer and better quality products.

In 2009, the policy was revised to further enhance the capability and competitiveness of the domestic automotive sectors in response to increasing liberalisation pressure and changes in the global automotive industry. The government attempted to attract investment in high technology sectors such as electric and hybrid vehicle production (MIDA, 2010). The revised NAP in 2009 was not much different than the initial NAP, except the government introduced more incentives for foreign companies to promote high tech and value-added activities. The underlying reason was to build linkages with Bumiputra vendors to improve competitiveness. In 2014, the government revised the NAP again by putting emphasis on green initiatives in order to become a regional hub in energy efficient vehicles (EEV) as part of market expansion and to attract more foreign investors[35]. The shift to green initiatives can be associated with the success of the 'eco-car' in Thailand, which provides

[35] In 2014, the government added two objectives to the National Automotive Policy: (i) to develop Malaysia as the regional automotive hub in Energy Efficient Vehicles (EEV) and (ii) to enhance the ecosystem of the manufacturing and after-market sectors of the domestic automotive industry.

lucrative tax privileges and excises duty rebates for foreign assemblers and suppliers (Doner and Wad, 2014).

The NAP is seen to adopt a market-based economy policy that intends to reform the domestic automotive industry to become more competitive. In the policy, the government acknowledges issues related to problems in the domestic automotive industry such as low economies of scale, high production costs, low usage of technology and knowledge application, non-optimised supply chains and development of human capital (NAP, 2014). The key to resolve the abovementioned problems is to enhance competitiveness with the liberalisation of the domestic automotive industry. In view of these challenges, the government aimed to address mainly new investment in specific sections of the automotive industry (for example, in hybrid and electrical cars or fuel efficiency), market expansion (partnership with foreign companies), moving up the supply value chain, improvement of technology and development (this includes R&D), and human capital development (ibid, p.5).

Considering the tariff was already reduced considerably, institutional arrangements were made in the policy to enhance competitiveness in the domestic automotive industry by the government opening up the Manufacturing License (ML) for manufacturing and assembling activities. The government provided tax incentives such as the Pioneer Status of 100 per cent fiscal reduction for 10 years and the Investment Tax Allowance of 100 per cent for five years, for foreign companies that promote high value-added production on parts and components (NAP, 2009). This includes investment in hybrid and electric vehicles to attract more OEMs to move their operations into Malaysia. As stated in the previous chapter, among other non-tariff barriers in Malaysia's automotive industry, the Approve Permits (AP) were import quota permits introduced in the late 1960s as part of the redistributive programme under NEP. AP was introduced to facilitate Bumiputra participation in the automotive industry. There are two types of AP: open AP, which is an import permit for used vehicles, and franchise AP, which deals with producers of new vehicles that have equity condition. Since non-tariff barriers can distort the automotive market, in the NAP the government set to phase out the open AP system by 31 December 2015 in order to gradually eliminate the imported used cars that could potentially undermine the CBUs in the domestic market. The government also committed to remove the franchise AP by 31 December 2020 (MITI, 2014).

One of the significant elements in the NAP to enhance the competitiveness of the national car manufacturer is the aim to form a strategic partnership between Proton and global automotive producers. This is part of the economic transformation program under Najib's administration to strengthen the position of the national car in the automotive production network through a private-led initiative. In their assessment of Malaysia's automotive industry, Wad and Govindaraju (2011) observe that the government attempts to retreat from the national car project that they cannot handle by having partnerships that could at least address the large idle capacity of Proton. Furthermore, the government introduced the Malaysia Automotive Institute (MAI) in 2010, a newly established government agency that provides resources to assist domestic automotive development (technology, marketing and management) including for the local vendors. This agency can help facilitate resources gaps for national car marker and local vendors and coordinate linkages with other OEMs. The intention of the NAP was to advocate strategic partnerships that enable the national carmaker to be competitive, address long-term viability, access the latest technology (including technology transfer) and, more importantly, enable Malaysia to play a major role as a regional hub for the automotive industry by increasing exports (Natsuda et al., 2013; MITI, 2009). However, forming strategic partnerships remains questionable in the NAP due to Bumiputra and other political interests linked to Proton (Nehru, 2012) (further discussion on chapter 6 and 7).

Although the NAP adopts a pro-market oriented approach, the liberalisation of the domestic automotive industry is not done straightforwardly. This is because the government has substantial interest in heavy industrial development in Malaysia. Institutional arrangements in the industrial policy are deeply rooted with political consideration (Gomez, 2016). The policy in the automotive industry is embedded with political interest, so policy arrangement by the ruling elite is to protect the domestic automotive industry, especially the national carmakers and their vendors. Though the government shows market reforms in the domestic automotive industry, policymakers tend to carve out policy space in order to maintain a protectionist stance under the NAP (Segawa, et al., 2014). While the Malaysian government has reduced tariffs under AFTA and WTO obligation, new excise duty has been introduced as a way to protect the national carmaker (see table 5.8). The government imposes excise duties between 75 and 105 per cent for imported CBUs and CKDs components. The tax structure is considered the highest in the ASEAN region[36] (Peerce, 2015). The national cars are given 50 per cent exemption from excise duty (Jomo, 2007), and although the exemption was due to expire in 2004, the government continues to provide the tax exemption for the national car (Reuters, 2004). The excise duties discriminate prices between national and non-national cars, which inflates non-national car prices. This is intended to make the national cars (Proton and Perodua) less expensive in the market (AMCC, 2009). In short, the excise duty provides a decisive cost advantage for the national

[36] Excise tax for both CBUs and CKD in Thailand is between 25 to 50 per cent, in Indonesia it is between 20 to 75 per cent and in the Philippines it is between 15 to 100 per cent. The excise duties depend on the engine sizes (Peerce, 2015).

cars so that they are able to maintain sales in the market. It is estimated that Proton would be significantly more expensive if it had to compete in a level playing field with global brands, especially with Japanese automakers (Fujita, 1999; Nehru, 2012).

Table: 5.8 **Excise Tax in Malaysia**

Engine capacity (cc)	**CBU Vehicles**		**CKD component**	
MFN Passenger Vehicles	Tariff	Excise Duty	Tariff	Excise Duty
< 1800	30%	75%	10%	75%
≥ 1800 - < 2000	30%	80%	10%	80%
≥ 2000 - < 2500	30%	90%	10%	90%
≥ 2500 - ≤ 3000	30%	105%	10%	105%
> 3000	30%	105%	10%	105%
ASEAN (CEPT) Passenger Vehicles				
< 1800	0%	75%	0%	75%
≥ 1800 - < 2000	0%	80%	0%	80%
≥ 2000 - < 2500	0%	90%	0%	90%
≥ 2500 - ≤ 3000	0%	105%	0%	105%
> 3000	0%	105%	0%	105%

Source: Malaysia Automotive Institute (MAI) 2015

Note: effective 1st April 2015 government will introduce Goods and Service Tax (GST) 6% which will replace the existing Sales and Service Tax. GST is a value added tax therefore it applies at each stage of the business transaction, from manufacturer, distribution, retail and to the consumer. It is expected to increase car prices including national cars.

While excise duty was introduced to protect the national carmakers, it is important to note that the overall tariff has been reduced significantly, from 30 percent for CBU and 10 percent for CKD under the WTO commitment. Under CEPT, all ASEAN member governments have reduced tariffs to zero percent for both CBU and CKD. When there is a significant decrease of nominal tariffs (referring to the tariff imposed when a final product enters a country), this shows that the country has reduced its barriers for other foreign automobiles to enter its market. In general, the imposition of nominal tariffs raises prices by the amount of the tariff, which can distort factors of production towards protected sectors (Haque and Siddiqui, 2017). As a consequence, tariffs favour imports in competing sectors at the expense of other sectors that have comparative advantages in exportable surplus. While nominal tariffs are part of a protectionist tool to restrict final product entering a market, they may not necessarily reflect the real protection of the industry. As Corden (1966, p.222) points out, nominal tariffs apply to the commodity only (final product), but resources move between economic activities, so to understand the resource-allocation effect (importable input) of a tariff, the importable input needs to be calculated in order to reflect the 'effective' protective rate of an economic activity. Since developing countries tend to use importable inputs (such as raw materials and intermediate products), by taking into account the importable input it will then reflect the true picture of protections, also known as the effective rate of protections (ERP). The concept of ERP is the total effect of input and output tariffs on the production process, and it is widely used to assess protective structures, particularly in developing countries (Greenaway and Milner, 2003).

Theoretically, under the ERP calculation the higher importable input goes into a product (in this case imported auto parts and components for car production), the higher the effective rate of protections – often higher than nominal tariffs (Corden, 1966). ERP explains that the domestic cost (or the value added) involved in the production usually will be above world cost. Assuming the importable input is tariff free or is less than the nominal tariff, higher importable inputs mean an increase in the domestic cost (value added) in the production process. This is because the value added domestic price is likely to be more than value added in world price. Therefore, if the duties of the importable inputs are less than the nominal tariff, it underrates the real effect of the actual protection of a particular industry. Of particular note, a country's foreign exchange also impacts ERP (Greenaway & Milner, 2003; Corden, 1966, p.224), because protection can improve balance of trade. Hence, it is likely to appreciate the exchange rate of a country's currency. Once exchange increases this will lead importable input prices to fall, and this will bring down ERP. Therefore, the implication of ERP differs from country to country depending on their strength of currency.

In the case of Malaysia, the automotive sectors remain highly dependent on importable parts and components for car production. As Jomo (2007) points out, even though there is low nominal rate of protection, low domestic value added shows a high effective rate of protection. According to Alavi (1996, p.174), before Malaysia committed to WTO binding tariffs it was estimated that the ERP of the transport and equipment was 252 percent in 1987. During that period the government also implemented the localisation policy and mandatory deletion programme as it expected to raise the ERP. However, after making commitments to the new tariff structure under the WTO and abolishing the localisation policy, the recent available estimates for ERP for the automobile industry in Malaysia is 57 percent (Nehru, 2012). Though ERP has been brought down significantly, the fact remains that it remains higher than the nominal tariff, making the automotive sectors a highly protected industry in Malaysia. In addition, the weak exchange rate in Malaysia against the world currency also suggests that the ERP tends to be higher.

The Malaysia government continues to maintain non-tariff barriers to shield the domestic automotive industries. As stated earlier, the government relaxed the issuance of manufacturing licenses as part of opening up the domestic automotive market. However, ML will be given only to certain segments of the vehicle production, notably to the assembling of luxury passenger cars with an engine capacity of 1800cc and above, and with price of no less than RM150,000. ML will also be issued to motor vehicle hybrids and electrical vehicles (including with EEV category), pick-up trucks and commercial vehicles (MITI, 2009; MACPMA, 2008; NAP, 2014). Although the government partially relaxed its non-tariff barriers, it tries to limit the import of foreign cars that constitute a direct threat to national carmakers. In particular, this applies to vehicle products for 1600cc (and below) and small size engine vehicles, the market segment dominated by the national car. This means institutional arrangement is made among policy actors in the NAP to support the national car project.

The government continues the open AP system as one of the non-tariff barriers to limit numbers of imported CKDs and CBUs. Initially when the government introduced the NAP in 2006, the AP system was scheduled to be removed in 2010, but was differed until December 2015. However, in 2015 the government decided to continue the open AP until 1 January 2017. The Minister of International Trade and Industry stated that the decision to postpone the open AP system was because the business of imports and distributions of imported used cars have contributed significantly to the automotive industry and to socio-economic development. This included contribution to other service sectors (banking, insurance, shipping and logistics) and generating employment opportunities (The Star, 2015). To abolish the AP system is difficult because such economic rents are captured by politically linked individuals, who mostly have close connections with UMNO members (Lim, 2004). These individuals can threaten any individuals or business groups that attempt remove the special import permits. AP has the same impact on import quotas, which can cause distortion in the domestic market (WTO, 2012). To reduce this impact, under the NAP the government attempts to streamline the AP system by limiting the number of AP holders. An in-depth audit will be implemented to ensure APs are not misused by individuals. New applicants for AP have to prove having minimum paid up capital of RM1 million[37] and a ready premise to operate auto dealership (MITI, 2016). New application for open AP requires a payment of RM10,000 for each permit, money which will be channelled to the Bumiputra Automotive Development Fund as part of assisting Bumiputra companies venturing into the automotive industry and other businesses (MIDA, 2012).

[37] Full details of the AP requirement can be assessed in MITI website.

Despite the fact that the NAP is an attempt to liberalise the domestic automotive market, the Bumiputra agenda still constitutes an important part of it. Theoretically, emphasising certain ethnic group development is inconsistent with the neoliberal approach, because giving preferential treatment to certain ethnic groups defeats the purpose of equal access to compete for resources in the policy (Ho, 1988; Whah, 2012, Aun, 2002). It also creates an unlevel playing field due to artificial distortion formed by the state. Such affirmative action policy could further create rent-seeking behaviour among the groups to obtain access to state resources (Khan, 2000; 1996). Pertinent to this regard is that, when ethno-development retains an agenda in the automotive industry, the government could maintain the patronage system in the industry to ensure Bumiputra vendors can benefit from such policy by having close connections with the politicians and bureaucrats to obtain preferential access to state resources (Gomez, 2009; 2016). In fact, the affirmative action policy was under scrutiny under Najib's economic transformation plan and there was a move to reduce the emphasis on it; that is, to do away with Bumiputra policy because ethnic-based development had slowed industrial development (Fauzi and Takiyuddin, 2014; Tan, 2010). Najib's administration intended to replace the ethnics-based policy to a need-based one irrespective of race. Fauzi and Takiyuddin (2014) observe that the government attempts to allow private-led development in an attempt to scale down the role of the state in the market. When Najib announced the decision to end the Bumiputra policy (The Star, 2009), there was mounting pressure from the UMNO right wing, including Mahathir Mohammad (Proton's advisor), which forced him to re-institute the Bumiputra policy[38] (Gomez, 2016). In relation to this, the NAP remains the emphasis of Bumiputra participation in the automotive industry. Special funds are allocated to increase the Bumiputra role in automotive industries.

Under the NAP the government has not completely withdrawn their protection for local vendors. There are several measures in the NAP to ensure the sustainable development of the national car and local producers of auto kits and components. As mentioned earlier, the government has phased out the localisation policy which was deemed to obstruct a free business environment in the host economy. This provides a more open business environment for private firms to procure auto kits and components from competitive vendors. However, phasing out such policy is not done straightforwardly, as Natsuda and Thoburn (2014) describe that Malaysia's government still carves out some dubious policy measures as a way to protect the domestic firms in the automotive industries (p.1363). The obvious method in the NAP is that the government provides tax exemption for

[38] Gomez (2016) points out that the ailing UMNO-led coalition depends on majority support from poverty-ridden rural areas in the Bumiputra majority states of Sabah, Sarawak, Perlis and Kedah. If policy does not explicitly mention Bumiputra interest this may jeopardise political support for UMNO (p.8).

companies that promote exports with a significant portion of the assembly activities value added in Malaysia. Tax exemption is given based on the percentage in the values assembly in Malaysia[39]. The tax exemption policy does not force companies to source locally made auto parts and components like the previous local content policy, but rather encourages assemblers to procure from the local firms with tax exemptions.

In the NAP, the policy states that the government will continue to provide institutional support for local firms, including financial (soft loans & grants) and non-financial support, so that vendors that are linked to national carmakers can grow in the competitive market. Among other measures introduced in the NAP to encourage growth of the local automotive firms are the Industrial Adjustment Fund, the Automotive Development Fund and the Industrial Development Linkages (NAP, 2014). These measures may not obstruct a freer business environment in domestic automotive sectors but they are instruments devised by the state to facilitate the domestic automotive industry, especially national carmakers and local vendors linked to them. The Industrial Adjustment Fund (IAF)[40] is a fund given to a company to strengthen a particular sector (in this case automotive sectors) and can be linked to local content. The IAF works to enable assemblers to receive incentives (for example, interest free loans and grants) based on scale and industry linkages, upgrading of machinery, component development costs and technology enhancements (MITI, 2006). Assemblers that engage in such activities to facilitate the local vendors will have access to state grants and financial supports. Furthermore, assemblers that promote competitive Bumiputra in the automotive industry will obtain IAF. Proton and Perodua are the main beneficiaries of the IAF.

Similar to the IAF is the Industrial Linkages Program (ILP) introduced under the NAP. The ILP is a program initiated by the government to link local vendors and foreign companies as part of facilitating vendor engagement in the foreign companies' supply chains (UNCTAD, 2013). Vendors that are linked to foreign assemblers are required to manufacture products or undertake activities in the List of Promoted Activities and Products in the ILP. This can be linked to the local content requirement, because foreign assemblers working with local vendors can obtain excise tax according to the values of locally procure. The ILP requires assemblers to source auto parts from vendors that are part of the

[39] Tax exemption on statutory income for assemblers is enhanced from 10 to 30 per cent of the value of increased exports, provided the goods attain at least 30 per cent value added, and from 15 to 50 per cent of values of increased exports provided that the goods attain at least 50 percent value added (see MITI, 2016).

[40] Industrial Adjustment is defined as any activity of a company operating in a sector within the manufacturing industry to restructure the company by way of reorganisation, reconstruction or amalgamation within that particular sector, with a view towards strengthening the basis for industrial self-sufficiency, improving industrial technology, increasing productivity, and enhancing the efficient use of natural resources and manpower management (MITI, 2017 see factsheets- incentive for industrial adjustment fund).

Proton Vendor Association, Perodua Vendor Association or Malaysia Automotive Components Parts Association (MACPMA). The Automotive Development Fund (ADF) is akin to a fiscal stimulus fund. The ADF aims to rationalise and strengthen local vendors' competitiveness by providing low interest loans. The loan is to facilitate local vendors in improving production activities and upgrading. Also, ADF facilitates the merger and acquisition of weaker vendors due to the reduction of the CKDs tariff (ibid p.53). Similarly, the ADF is given mainly to the Proton or Perodua vendor's associations. This is part of the aim to facilitate Bumiputra development in order to be competitive in the automotive industry (MAI, 2015).

5.4 Conclusion

This chapter explores the trade liberalisation pressure for Malaysia's automotive industry which gave rise to the National Automotive Policy. The outcome of the NAP is seen as the government adopts a more open economy in its automotive sector, which has been protected since the formation of the national car project. A pro-market oriented policy reform in Malaysia's domestic automotive industry seems inevitable. Liberalising the domestic automotive industry is crucial to expand market access, productivity gain, technological advancement and capital accumulation. Other ASEAN member states have started opening up their automotive sectors, given the potential of the sectors to expand and improve manufacturing activities. However, in the case of Malaysia, opening up the market could undermine the national car project that is embedded with state interests. The country cannot operate in a protective environment for a long period of time, though, because this may limit market access, productivity gain and growth. There is a need to liberalise the domestic automotive industry. The policy arrangements made by policy actors are unlikely to make the national car competitive in a level playing field or undermine the local vendor interests.

While the NAP is seen as a pro-market oriented policy reform to constitute a level playing field for other automakers in the Malaysian market, the policy is coordinated to protect the domestic automotive sector. Despite the poor performance of sales and exports, the policy seeks to preserve the interest of the national carmakers. Institutional arrangements are made by the state elites and industrial groups to continue to facilitate the national carmaker in the market and to preserve local vendor interests. The government's interests are entrenched in the institutional arrangements, making it difficult to pursue a market-based policy. As a result of the arrangements, the policy is crafted to shield the domestic automotive industry, such as by imposing a high excise duty. Low tariffs imposed on imported CBUs and CKDs, licenses and approved permits still exist as non-tariff barriers to limit imported cars that directly threaten national cars, maintaining the localisation policy and special funds for the national car projects and the local vendors. By incorporating Bumiputra interest in the NAP as one way to protect the national car project, the state elites can mobilise more state resources to secure the growth of the sector in terms of 'national interest'.

Chapter 6

The Politics of the National Car Project

6.0 Introduction

What makes Malaysia's automotive industry different from other ASEAN countries engaged in automotive production? While most ASEAN countries have move towards more neo-liberal policy after late 1990s, and in the 2000s abolished localisation policy and in 2010 remove intra-ASEAN tariff to promote the automotive industry, Malaysia retains a limited neo-liberal approach in its own automotive policy. The role of institutions in Malaysia has enabled the governing elite to play a strategic role in orchestrating the direction of its industrial policy relating to the automotive sector. Unlike other Southeast Asian countries, Malaysia has successfully launched its national car project under the heavy industrialisation programme. Since Malaysia pursued its nationalist heavy industrialisation, the dynamic of political economy and politics in its industrial policy on the automotive industry has evolved around the interest of the national car company, Proton. The overarching purpose of the formation of the national car company is to rationalise the automotive sector in the country. It is part of the developmentalist state approach to enable the country to pursue 'national champion products' and, more importantly, to enable the Bumiputra group to lead automobile manufacturing activities.

The state vested interest in the national car company has facilitated the development of the Proton, hence automotive policy has been constrained by the Made-in-Malaysia car interest. The formation of Proton in Malaysia signifies that the country adopts an independent mode of heavy industrial development, which includes developing its own national car production and being less dependent on foreign automakers. Given the strategic role of the governing elite to facilitate the growth of national carmakers, this chapter will assess the growth of Proton and the extent to which it has served the purpose of the country's heavy industrial development. It can be argued that the government has facilitated the national car project to become a full-fledged automobile carmaker. It is a source of national pride for Malaysia as a developing country capable of manufacturing its own automobile, and it has increased participation of Bumiputra in automotive sectors. While the government has been able to promote the growth of Proton, the political considerations overriding economic priorities have influenced the direction of Proton. Political influences that were crucial to promote the growth of Proton also have had a constraining effect for the national car company in becoming a competitive exportable brand. This chapter provides a discussion on the national car project and the national automotive policy being geared towards full-fledged car manufacturers facilitated by the role of institutions. Secondly, it examines the politics of Proton as the flagship of the national car manufacturers, which further reveals the strategic role of the political elite in facilitating the growth of Proton and also constraining factors.

6.1 Malaysia's National Car Project

Different institutional setting of a state produces different industry policy. Institutional arrangements taking place by principle economic actors in a particular institutional context produce different developmental strategies and outcomes. This is due to the role of institutions as the 'rules of the game' that structure, constrain and shape the interaction of the economic actors in configuring industrial policy. Preferences on industrial development are part of a function expressed in the institutional arrangements formed by the actors, who mainly include political actors, bureaucracy and domestic enterprises. The preferences, ideas or strategy being adopted mainly depend on the institutional structures of the power relations between those actors in the policy-making institutions. The political elite in Malaysia have a strong dominant role in institutional arrangements to assert their interest in automotive policy, in this case namely in the formation of national car projects (see further discussion in Chapter 7). The former Prime Minister Mahathir did not go through proper deliberation at the parliament and even with the economic technocrats like EPU and MIDA or local components manufacturers when he first introduced the national car project plan (Jomo, 1989; Tan, 2008).

As stated in the earlier chapter, the national car project forms a significant part of Malaysia's industrial policy. It has also suggested that the state adopted a developmentalist state approach like Northeast Asian countries (Abbott, 2003, Kanapathy and Hazri, 2013). The project became part of the country's *developmental legitimacy*, where development in the automotive form is the most important legitimising principle of the state, while the national automotive policy is characterised as *plan-rational* to promote the automotive sector by allocating resources and protecting the enterprise (Abbott, 2003; 2004). This enabled policy actors to coordinate, prioritise and mobilise resources in the policy-making institutions. The NAP has been primarily evolved around the interest of national car project. The NAP has strong adaption to the domestic political economy, and while development of the automotive industry is an important end goal, political considerations can subordinate economic goals.

Though the national car project is embedded with political interests, it is intended to strengthen the country's industrial base and promote technological innovation activities. The automobile sector is a highly capital-intensive sector that requires a substantial amount of resources to be invested in various areas such as physical infrastructures, modern technology and human capital development. Though at the outset Malaysia had a limited industrial base for the development of automotive industry, given the existing institutional capacity the political institutions able to allocate state resources attempted to shift its comparative advantage (Lall, 1995). Through early development of the national car project, Proton depended considerably on Japanese technology (in a joint-collaboration with Mitsubishi Motor Corporation), but the intention was to move up the production chain to become a full-fledged carmaker. The interview with P1 noted that:

'…*Proton is a national interest that planned to become a homegrown Malaysian car and as part of industrialising the country with automotive sectors, so policy will move to this end…also to show the world that developing country can do it as well*…'

For developing countries it is feasible to develop an automotive industry. According to Bloomfield (1978), a country developing an automotive sector will undergo four likely stages, though it is by no means inevitable that all countries will complete this sequence, especially developing countries dependent upon foreign companies (cited in Abbott, 2003):

- Stage 1: The import of completely built up (CBU) vehicles by local retailers. This tends to be limited in scale because of high transportation costs and government trade restrictions.
- Stage 2: The assembly of completely knocked down (CKD) vehicles imported from the major automanufacturers. This involves domestic production of replacement parts and components (REM), original equipment manufacturer (OEM) parts for car assembly, and domestic production OEM of key parts (engine and engine-related components). This allows saving transport costs and the opportunity to make minor modifications for local markets.
- Stage 3: The assembly of CKD vehicles with increasing locally-made content. This both depends upon and encourages the development of a local components industry.
- Stage 4: The full-scale manufacture of motor vehicles, including domestic design of car bodies and other components. This tend to be restricted to a smaller number of countries

than stage two and three. Malaysia's automotive policy has facilitated the national car companies, especially Proton, to be a full-scale national car manufacturer.

Once Malaysia started to develop its automotive policy it has gradually moved from stage 1 to 2. The localisation enabled local auto parts companies to manufacture REM and to enter into OEM productions in stage 2. The local auto parts manufacturer improved their production through joint ventures with foreign auto carmakers (Doner, 1992; Okada, 1984; Torii, 1991; Abbott, 2003). Automotive policy in Malaysia is geared towards 3, and the influx of Japanese, Korean, American and European auto makers relocating their production activities (usually mid-end tier activities) is the evidence the foreign companies utilise the locational advantage of the region for auto kits supplies (Doner et al., 2004). As discussed in the earlier chapters, the local content policy is a strategy for government to strengthen the auto parts and components industry. Though local content to a certain extent is able spur industrial development, depending so much on foreign automakers limits the growth of heavy industrial development. Subsequently, Malaysia came out with the 'national car project', Proton, in which automotive policy emphasis moved towards stage 4 with the manufacture of its own motor vehicles as a 'national champion product'.

To this end, Malaysia's government formulated industrial master plans to ensure the national car project could arrive into stage 4 (see table 6.0). The formation of the national car project was the lynchpin to meet the industrial master plan of the country (Ariffin et al., 2016). The first Industrial Master Plan (IMP I 1986-95) was introduced subsequently after the government launched the heavy industrialisation programme. IMP I emphasis was to lay the foundation of manufacturing industries, particularly non-resources based for industrial development. Technological acquisition and upgrading to enhance production, processing and value addition became a central part of industrial policy. Formation of the national car project through Proton was to lay the foundation for manufacturing activities. Collaboration between with Mitsubishi Motor Corporation and later with French car company Citroen was part of strengthening technological acquisition at the early stage. Proton Research and Development centre was set up to carry out full-scale research on computer aided engineering design, model making and manufacturing (Tham, 2004b).

Table 6.0: **Phases of Industrial Master Plan and National Automotive Policy**

Industrial Master Plan I	Industrial Master Plan II	Industrial Master Plan III
1986 - 1995	**1996 - 2005**	**National Automotive Policy** **2006 - 2020**
(three broad objectives)	Six focus initiatives Moving Beyond Manufacturing Operation	Towards Global Competitiveness
1. Ensure rapid expansion of the economy through accelaration of manufacturing sector growth 2. Promote efficient and optimum utilisation of natural resources through value added manufacturing activities 3. Lay foundation for development of indigenious technological capabilities	1. Indigenous R&D and Technology 2. Design Capabilities 3. Integrated supporting industry 4. International marketing 5. Development of own Brand 6. World Class, world scale	1. Long-term global competitiveness through transformation and innovation of the manufacturing 2. Competitive and sustanaible domestic automotive industry 3. Regional automotive hub in EEV 4. Value added activities 5. Increase export of vehicles and automotive components 6. Safer and better quality products with competitive price

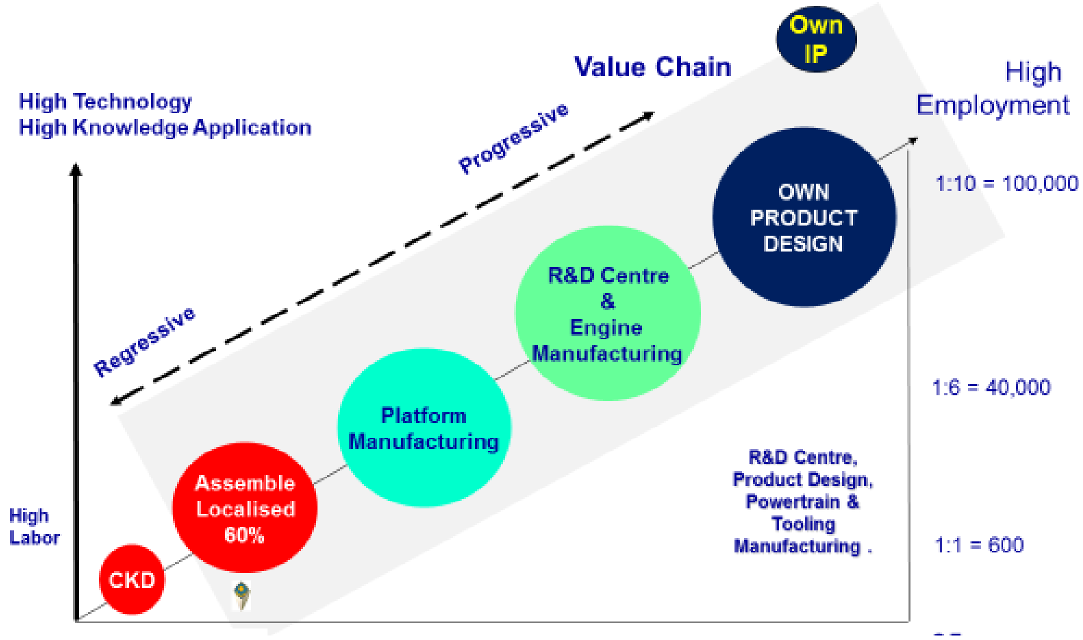
Source: Ismail, 1990; NAP, 2014; MITI, 1996, MITI, 2006

Subsequently, IMP II (1996–2006) was formulated to increase productivity and competitiveness, building upon IMP I. As such, IMP II reiterated the focus on the development of locally produced components and technological deepening this sector. At this stage Malaysia was preparing to abolish the local content requirement, therefore the plan was to expand scale of production, upgrade technological capability, develop of human resources, and increase product and engineering capability and production process technology (Malaysia, 1996). The IMP II attempted to broaden manufacturing capabilities through the strategy of cluster-based industrial development, commonly dubbed as *manufacturing plus plus* (manufacturing ++). The development of an industrial cluster provided the state a strategic focus on selected industries, especially the national car projects, to move up the global values chain. IMP II entails more development of physical infrastructures and strengthening linkages. The cluster-based industrial development led the government to establish Proton City, Tanjung Malim, the second factory built with a production capacity of more than 500,000 for Proton (Athukorala, 2014). Special institutes such as the Technology & Industry Advancement Programs were established under MITI to oversee the progress of the automotive industry.

Despite the adverse economic and social costs of the ‘national champion product’ (the national car project), including high cost of car productions and auto kits and components, high dependence on government grants (subsidies), and limited technological capabilities, the overall progress of the national car has arrived into stage 4 (see figure 6.1). The national car companies such as Proton and Perodua have been able to manufacture and design their own cars (Rashid, 2006; Govindaraju, 2010). Proton was able to do this after the company acquired British Lotus Group. With full ownership of the British car company, Proton was able to access Lotus technology to develop its own design and engine. Perodua[41] also produces and designs its own car in a lower segment of Malaysia’s automotive market, though the company is strictly monitored by its partner Daihatsu, which is under Toyota’s *keiretsu* (Wad, 2008). In general, both national car companies have the capacity to manufacture their cars within the existing platform, manufacturing stamping dies, plastic moulds, powertrain design, R&D and engine manufacturing which characterised as capital intensive activities (Rashid, 2006).

[41] Initially Malaysia company has majority share over Perodua, after restructuring the company in 2001 the Japaneses company – Daihatsu, hold majority shares (Rosli, 2008, p.94). Perodua has strict application of the Japanese production standards and procedures. Basically Malaysia company mainly manages sales of the automobile.

Figure 6.1 **Proton Development**



Source: Kamarulzan, 2017 (slide shown during interview)

Despite criticism levelled upon the national car company, based on the interview data most respondents agreed that if it was not for Mahathir orchestrating the implementation of the national automotive policy the country could not have gone this far. Doner (1992), Fujita (1999), Rashid (2006), and Tai and Ku (2013) argue that Malaysia took 'independent development' in its industrial policy in the automotive sectors, while most of Southeast Asia still retained 'dependency development'. For instance in Thailand, Indonesia and the Philippines the domestic automotive sector is highly dependent upon Japanese companies' production network (Hatch and Yamamura, 1996; Kobayashi et al., 2015). Taking an independent development mode means the industrial policy enabled the national car company to pursue export-oriented strategy and less dependence on foreign automakers. However, the extent of the benefits of taking an independent development mode in industrial policy remains a debatable issue for a developing country like Malaysia. Though the national car resembles an independent mode of automotive production, in terms of economies of scale and technological advancement it remains limited. Most of the technology used still depends on foreign companies, including purchasing licenses (the right to use foreign technology), which reflect limited indigenous technology development to compete in the market (Tham, 2004b; Zhang et al., 2017; Rasiah, 2011c). This affects the competitiveness of the national car company. Competitiveness has been the problem for the national car companies, particularly Proton, and for this reason the NAP retains the interest to facilitate Proton to enhance its competitiveness, with emphasis on innovative activities to improve technological advancement.

While this research will focus on the politics of Proton, which is the only national car wholly owned by Malaysian companies, it is important to point out the nature of Perodua. Even though both are labelled as national cars there is difference between Proton and Perodua. As stated in Chapter 4, Perodua is the second national car project established in 1993. The early formation of Perodua was a joint collaboration with Daihatsu and Mitsui and several government-controlled companies such as PNB Equity Resource Corp Sdn Bhd, Med-Bumikar Mara and UMW Corporation, where Malaysian equity amounted to 68 percent and Japanese equity 32 percent (Wad and Govindaraju, 2011; Rosli, 2006). The establishment of Perodua and Proton is somehow similar where both began as joint ventures with a Japanese company. Perodua was formed to further complement the Proton vendor programme, which had limited economies of scale. Having the second national car that focussed on the lower segment of the automobile market, Perodua could procure parts and components from Proton vendors without directly competing with Proton's models and market.

Based on the interview data analysis, Perodua was not merely formed to expand the vendor development programme, but the government also intended to pressure Mitsubishi for being slow in transferring technology to Proton. There seemed to be resistance from Mitsubishi to transfer technology. Although purchasing production techniques and rebadging the Mitsubishi models was part of the learning-by-doing process, it was not the overarching intention of Proton. Technological advancement in Proton did not really occur due to limited technological transfer by Mitsubishi. Therefore, the government launched Perodua as an alternative strategy to pressure the Japanese company to improve Proton's technological capacity. At the outset, Perodua also depended on the government's protectionist measures to grow in the market. It 'freerides' the automotive policy at the time when Proton was introduced in the market with high tariff barriers, tax exemptions, financial supports and subsidies from the government. The formation of Perodua has increased the localisation programme and promoted the vendor development programme (Fujita, 1999).

In 2001, Perodua began to restructure its joint venture agreement. The new agreement saw 72 percent Malaysian companies equity on a vehicle sales firms, while the manufacturing and engine manufacturing firms were 51 percent controlled by Daihatsu and Mitsui. The interview with C5 reveals that the second national car company has control over sales. Having a majority share of the vehicle sales, Perodua retains its national car status and remains a beneficiary of the National Automotive

Policy (NAP). Based on the terms of policy in NAP that intended to support the national car like Proton, Perodua also benefited from policies such as the Industrial Adjustment Fund, lower excise duties and tax exemptions.

The new structures allowed the Japanese companies to have more control over manufacturing and engine development. Manufacturing and engine development are highly capital-intensive activities and involve in R&D for engine manufacturing. They are the central activities for car production. Since the Japanese have controll over the manufacturing and engine development, they can employ a strict monitoring system among vendors engaged in Perodua production chains. As stated earlier, the quality of an automobile is highly dependent on the competency of the suppliers for accessing auto parts and components. Othman and Rusop (2007) point out that vendors linked to Perodua tend to have joint ventures with Japanese suppliers (OEMs) and expect vendors to supply good quality auto kits. Most vendors working closely with Japanese suppliers benefit from technological transfer and improve firms' capacity and productions. This enables vendors to produce quality parts and components for Perodua. Since the second national car is linked to the Japanese production network, Perodua is able to learn Japanese management skills, cost effective production skills and modern technology (Natsuda, et al., 2013; Chrysler, 2010). The qualitative data suggests that though the Japanese have strict control over the selection of vendors, Perodua remains in facilitation of Bumiputra vendors. There are competitive Bumiputra vendors growing out of Perodua's production chain. Having a Bumiputra vendor enables Perodua to obtain designated funds for automotive development programmes under the NAP. Furthermore, the second national car company has been able to obtain more tax reductions because Perodua procures auto parts and components from local vendors. This means the car has higher local contents, and therefore it qualifies for higher excise duties exemptions.

Even though Perodua is a national car, after the restructuring of the joint venture agreement, Daihatsu and Mitsui have more control over the manufacturing operations and R&D (Malaysia Today, 2018). This also enables technological transfer to occur and improve the firm's technological capacity. Unlike Proton, after the restructuring agreement of Perodua, the government has less interference in its management and technological development. The local vendors and Japanese company have freer arrangements for procurement of parts and components. As Wad and Govindaraju (2011) point out, Malaysian stakeholders can secure rents from the subsidiary of the leading automaker in the world, the Toyota Motor Corporation that controls Daihatsu (p.166). By being labelled as a national car, the company retains some benefits under the NAP, which enables it to 'freeride' some of the policy terms to facilitate the growth of national car. As such, Perodua's competitiveness increases, which has been the reason that the second national car has expanded their domestic market and surpassed Proton, as stated in Chapter 5. Though Perodua is more competitive than Proton, the second national car remains dependent on the domestic market similar to Proton, as Perodua has not yet to become a competitive exportable brand in the global market (Paultan, 2018).

6.2 The Politics of the National Car Project: Proton

The Malaysian industrial policy to launch the national car project reflects institutional capacity, which expressed the ruling elite preferences in pursuit of industrial development. Interest and preferences in national automotive policy have evolved around the interest of the national car company in policy-making institutions. Various arrangements (formal and informal) have been made to secure the interest of local automakers in Malaysia's automotive market. This section will focus on Proton, which is the only national carmaker wholly owned by a Malaysian company[42]. Formation of Proton has shifted the focus of the industrial development plan and allocation of resources. It is one of the domestic enterprises most heavily dependent on government patronage (Athukorala, 2014; Tan, 2008).

Formation of the national car project had significant implications on the automotive industry. On the political front, the project is not just seen as modernising industrial development, but is also a symbol of nationalism (Jomo 1994). At the outset of the industrialisation process, the state took a developmental state approach through a nationalist import-substitute strategy. Since the institutions are embedded with racial consideration in economic development, the national car project is a response to the NEP objectives that aim for the creation of the Bumiputra business community and a Bumiputra labour force to lead modern sectors of Malaysia's economy, which were previously dominated by Chinese business groups (Wad and Govindaraju, 2011; Jomo, 2008; Doner, 1992). Having framed the project with nationalism, including ethnocentrism, the governing elite have used this project to come out with various policy arrangements to secure the national interest and allocate a substantial amount of resources to promote the growth of the national car project. The NAP has also

[42] This research was conducted before the government recently sold Proton's 49.9 percent share to Zhe Jiang Geely, a Chinese company who owns Volvo.

defended the interest of the national car and the Bumiputra against the backdrop of economic liberalisation pressure.

Though the political elite packaged the national car project with nationalist sentiment along with the need to increase participation of the Bumiputra group in the automotive sectors, there is also economic reason underlying the national car project. The purpose of the project is to rationalise the automotive industry (Abdulsomad, 1999; Doner, 1992). Prior to the heavy industrialisation programme, there were numerous foreign automotive manufacturers who produced low volume with rapidly changing models and makes. This led to market fragmentation and hindered the development of local auto kits and component producers. The rapid proliferation of models and makes has caused short-term production runs, uncertain demand and greater learning difficulty for local parts and components firms (Abdulsomad, 1999 p.288). Economies of scale are unlikely to be achieved in a fragmented automotive market with rapidly changing demand for new parts and components. As stated in the earlier chapters, though the local content policy was introduced foreign automakers resisted compliance with the policy due to inferior quality of parts and components. As part of the industrial development strategy, the government launched the national car project that is Proton to rationalise the automotive market. According to Doner (1992), after the formation of the national car project Malaysia's government managed to reduce the number of models produced by foreign companies, thus creating a more conducive environment for the development of Malaysia's automobile industry. This is similar to the strategy employed by the South Korean government when it restricts foreign auto companies and enables Hyundai to lead the automotive sectors.

The interview data suggest that the formation of the national car project was meant to have better control over the market, rather than having no control over the domestic automotive industry. Car production absorbs large funds due to imports, and purchase of cars and components from foreign companies would involve a big outflow of funds. This may result in a trade deficit, and furthermore the country may be unable to generate enough wealth internally to pay for imports. Having the national car enabled Malaysia to limit imports, though undeniably the country still needs to trade with other countries, at least as the national car project could reduce trade deficits. This is typical in a developmental state approach where governing elite attempt to pursue nationalistic industrial development with less dependence on foreign companies. The heavy industrialisation programme through automobiles was intended to address the problem of industrial dualism, foreign domination of high technology and export, while the domestic manufacturing sectors are restricted to small medium enterprises in mid or low tier functions such as assembly and subcontracting (Tan, 2014; Menon, 2008).

A pertinent question in relation to Malaysia's national car projects is asks to what extent the project has served its purpose for industrial development after more than three decades. Given that the role of institutions accentuates the strategic role of governing elites in policy-making institutions, to what extent has the role of elites facilitated the growth of the made-in-Malaysia car? The important discussion here revolves around Proton, because it is the only national car company owned by Malaysian corporations (see Table 6.2) and it is the result of the first national car project, which intended to rationalise the Malaysian automotive industry. Athukorala (2014) points out that Proton is the pinnacle of state-led industrialisation project that has continued to rely for survival on government patronage. As stated in Chapter 4, in 1983 Proton was established under the corporation between HICOM and MMC. After the company was privatised under Mahathir's privatisation plan, it appeared to signal the 'rolling back of state.' However, the reciprocal relationship remains close between the political elite and Proton. The political elite have substantial influence on the direction of the company. The main shareholders of Proton are still controlled by Bumiputra individuals. The sale of share has always gone through informal negotiations between individuals or has been based on close connection arrangements (the patron–client network) (Tan, 2008). The company has never gone through a competitive bidding (Tan, 2008; Gomez and Jomo, 1997). There are political influences to ensure that Bumiputra individuals are retained as major shareholders to meet the broad NEP objectives.

Table 6.2 **Historical Development of Proton**

Period	Events
1983	1st National Car Project approved between HICOM and Mitubishi Motor Corporation (MMC).
1990	Proton converted into a public company and listed in Kuala Lumper Stock Exchange in 1992. This is due to the privatisation plan in line with Mahathir's neoliberal policy to enable private-sector as an engine of growth.
1995	Khazanah (Ministry of Finance Investment Arms) sold 32% state to HICOM without open tender for an estimated RM 1.72 billion to Mega Consolidated Sdn Bhd. Then, Mega Consolidated owned by Diversified Resources Bhd (DRB), which was Yahya Ahmad's (a close friend of Mahathir Mohammad) main listed company. With the acquisition of HICOM both DRB and Mega Consolidated owned 95% of HICOM, hereafter became DRB-HICOM.[43]
1996	Proton acquired 64% stake in the British company, Lotus Group International Limited.
1997	Asian financial crisis caused DRB-HICOM financial difficulties and unable to pay Proton mounting debts.
1998	State-controlled Petronas took over DRB-HICOM's share of Proton. Later, Khazanah (a government linked investment agency), bought the largest stake of 43% and tied to DRB-HICOM.
2003	Proton became a fully private Malaysian company. The company also owned Lotus Group International Limited. Mitsubishi Motor exited as minority shareholders.
2012	Khazanah divested their stake in Proton, now it is acquired fully by DRB-HICOM (new owner is Sheikh Bukhari who is close friend of Mahathir Mohammad). DRB-HICOM financial performance and share price decline significantly after taking over the Malaysian national carmaker in 2012. DRB-Hicom reported a pre-tax loss of over RM821m (close to US$200m) in March 2016, compared with a RM502m profit in the previous year. Group revenues dropped by 11% to RM12.17 billion.
2017	*Latest development, In 2017, DRB HICOM sold its stake to Zhejiang Geely through which the Chinese company acquired 49.9 % share of Proton. DRB-HICOM also sold its Lotus Group stake to Geely.

Source: Tan, 2008; Wad and Govindaraju 2011; Just Auto, 2017
1 USD = RM3.059 (Malaysian Dollar) based on the currency 2010

Privatisation of the national car company in the early 1990s was part of the government strategy to improve the company management and increase efficiency, profit and technological upgrading. The company managed to improve sales (on the back of the government's high tariff protection) and management efficiency. Privatising the national car company meant it had more tractable management structures and being privately owned enabled the company to have more flexibility to determine its business strategy, investment and direction. The company was also able to decide the capital investment requirement for technological acquisition. The existing reciprocal relationship

[43] DRB HICOM also assembles CKDs such as Mercedez, Suzuki, Volkswagen, Audi, BMW.

between government and private enterprise enables it to devise allocation of resources and adjust terms of economic policy to allow the company to have sufficient resources to grow from their investments (Paultan, 2015). However, in the case of Proton, the benefits of privatisation such as flexibility and freedom are unlikely to occur because the role of institutions constrains the development of the company. There are strong political influences on the direction of the company, which include choices of candidates to head the enterprise (the government mainly prefers Bumiputra candidates), types of investments, technological acquisitions and selection of vendors, among others (Tan, 2008). Furthermore, the desire to promote Bumiputra participation in the auto industry has undermined the growth of the national car company, because the ecosystem of the auto industry neglects some productive producers (mainly Chinese suppliers) in the sectors (Jomo, 2007; Fleming and Soborg, 2016).

While the national car company has shown its capability to manufacture its own automobile and, by some indicators, to increase of production capacity over the years, its inability to innovate an exportable brand in a broader market outside of Malaysia indicates that there are problems in 'technological catching up'. The key competitiveness of the automotive industry is the ability to develop technological catching-up policy and graduate into higher levels in the production chain (Humphrey, 1998), enabling it to expand into the export market to improve economies of scale and scope. The main problem for Proton is technological upgrading (more discussion in the next section). In the haste of creating Proton in the phase of early industrial development, political leaders have failed to secure a favourable framework for technological transfer agreements with Mitsubishi and devise plans for exports. After more than a decade of joint collaborations, Proton merely 'rebadges' Mitsubishi models to sell in the domestic market, including models like Saga and Wira. Most technological transfer involves a high purchasing licensing contract with the Japanese company in order for local engineers to learn. However, learning in technological catching up seems limited because the company is unable to absorb, adopt, integrate and develop indigenous technology (Felker and Jomo, 1999; Tham, 2014; Rasiah, 2011a).

Though at the outset purchasing licences or contracting for copying machinery is important for the *learning by doing* process, for knowledge transfer through such a process a foreign company will usually bring in different levels of technology usually the less superior ones for local firms to be transferred. To improve indigenous technology, it emphasises the absorptive capacity of the local company to upgrade the existing technology (Okada, 1988). Though Proton has benefited from learning lean management, after sales service (repairs), on-the-job training (OJT) and technical training in Japan, the problem with Proton is that it does not have the right management or engineering expertise to meet learning requirements in technological transfer. This is partly due to the ethno-coloured policy embedded in the selection of staff and the patronage appointments of heads of management. While the bureaucracy like MITI plays a role in facilitating the growth of Proton, too many political influences in the bureaucracy has led to the government agency to be less meritocratic in assisting the national car company, including in decisions on subsidies and the formation of R&D organisation. This is largely influenced by the agenda to meet the needs of Bumiputra interest. Subsidies in the form of grants are akin to economic rents, which the government continues to provide for Proton with less consideration on its performance (Jomo, 2007). Though the government has set up technical and training organisation and R&D agencies, ethnic requirements have compromised the skill development in the automotive industry (Fleming and Soborg, 2016). Rasiah (2009) also argues that there is a lack of university-firm linkages that hinders research and development progress that can potentially create positive knowledge generation in the automotive industry. This has implications on the absorptive capacity of the company. Due to lack of technical expertise causing a slowdown in technological transfer, Proton engineers opted to use existing components and make modifications to the existing body (Tan, 2008; Yin, 2016).

The existing de facto protectionist measures in the automotive industry, made through high excise duties and designated special funds for Proton against the backdrop of shrinking domestic market shares and sales, reveals that the company lacks competitiveness. This also suggests that the national car company requires more resources in terms of technological advancement. To increase efficiency and competitiveness, the company needs to improve economies of scale, scope and speed to finance R&D intensive activities. R&D is crucial to compete in the market, but the cost to finance Proton technology and capabilities is substantial for R&D, the company needing at least more than US100 million in product development (Rashid, 2006). As discussed earlier, Proton tends to get preferential access to state funds in R&D through informal institutional arrangements. Though Proton is likely to obtain support from the government, its focus on the small domestic market with limited exports does not help its scale economies and could not support the cost of R&D activities (see table 6.3). Even to just break even, the company would be required to maintain sales at 100,000–200,000 units, which is unlikely in its such current situation (The Stars, 2017). For example, the new model Proton Iriz (1.3cc compact car) cost about US116 million (including R&D costs) and needs to sell at least 200,000 units within five years (The Star, 2017). To be economically viable, Proton has to attain at least 60 per cent of the domestic market, or 353,005 units (Goh, 2015), and this still underutilises its production capacity that is designed for 500,000 units.

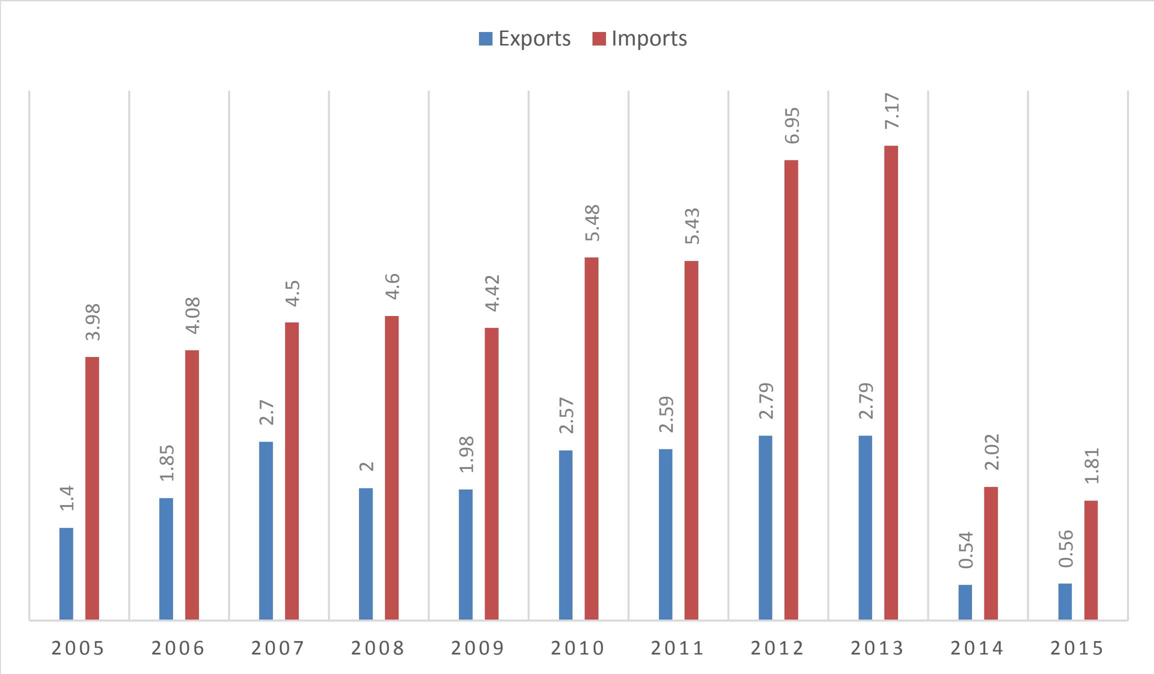
Table 6.3 **Proton's Sales and Exports ('000) and Growth Rate**

Years	Unit Sales ('000)	Exports ('000)	Exports growth rate %
2000	194.5	14.5	
2001	222.5	8.8	(39.3)
2002	222.9	8.2	(6.8)
2003	170	8	(8.2)
2004	177.9	17	112.5
2005	176.5	12.7	(25.29)
2006	125.1	14.7	15.74
2007	126.4	17.3	17.7
2008	160.6	17.3	0.0
2009	160	13.8	(19.8)
2010	177.7	15	8.7
2011	179.7	16.1	7.3
2012	143.6	13.3	(17.4)
2013	138.7	5.1	(61.7)
2014	115.7	4.3	(15.7)
2015	102.7	5.6	30.2
2016	76	n.a.	

Source: Various sources including Tan (2008), Wad and Govindaraju (2011), Proton Annual reports (2009), The Star (2016), Livelifedrive (2014), Malayonline (2014).

Since the inception of Proton the growth of the company has relied extensively on government protective measures, direct and indirect financial assistance and informal policy arrangements, as has been discussed in the previous chapters. Despite pressure from pro-market reforms, institutional arrangements that have taken place between the company and government have facilitated the national car project in the marketplace. Since Proton is backed by the government, the company has facilitated the development of vendors in Malaysia's automotive industry. Vendor development is the key to supply quality parts and components in the automotive industry. The large number of Bumiputra vendors has grown through Proton's supply chain network. The Bumiputra vendors also integrated into the Perodua production chain. Local auto parts manufacturers like APM Automotive, Sapura, Delloyd, TCM Stamping, Ingress and Hicom Teck See Manufacturing are some of the successful vendors. These vendors produced the original equipment manufacturer (OEM) parts and components, such as stamped metal and pressed parts, plastic injection moulding and machining, not just for Proton and Perodua but also for Japanese and European car companies (MIDA, 2014; 2016).

Figure 6.4 **Imports and Exports of Malaysia Motor Vehicle Components and Parts (RM Billion)**



Source: MIDA 2016

Though there are other vendors that have moved up the values chain of automotive parts and components production, however majority of the mostly Bumiputra vendors remain uncompetitive in the automotive production chain (Rosli and Kari, 2008; Wad; 2008). Most Bumiputra vendors enjoy the patronage system in Proton and it is difficult to remove them from the network because of ethno-economic requirements to develop the automotive industry (Gomez and Premdas, 2016). Since there is a requirement to source from domestic vendors, particularly for the national car company, given the limited technological and production capability among Bumiputra vendors, this raises imports of motor vehicles components and parts in Malaysia's automotive industry (see figure 6.4). The increase of imports over the years has led to a trade deficit in balance of payment because automotive equipment depends so much on imports, particularly from other ASEAN regions where there are well-established foreign OEMs (Tham, 2004b). This links back to the local content requirement as discussed in chapter 6 under the NAP. Some foreign auto firms made arrangements with local vendors to import certain components in order to obtain tax reductions.

6.2.1 Technology development

The formation of the national car projects through industrial policy was initiated to enable Proton to develop its own indigenous technology. The developmental state approach employed by South Korea to develop their automotive industry provided a certain degree of freedom for automotive companies like Hyundai/Kia to come out with strategies to acquire necessary technology that could be absorbed and integrated in the domestic automotive industry (Amsden, 2001; Weiss, 1995). The reciprocal relationship between the South Korean government and *Chaebols* negotiated plans for technological catch up. The bureaucracy played a strategic role in policy planning to guide the selected firms in heavy industrial development. Information obtained from the private enterprise through an arm's length relationship with the bureaucracy was used to plan policy that tailored the need for private enterprise to catch up and attempt to graduate into higher automotive production chains with less dependence on foreign auto companies (Amsden, 2001; Doner, 1992). The reciprocal relationship between the state and firms worked as a positive pressure for firms with a certain degree of freedom in decisions to increase their production efficiency, in order to sell their products in the export market (Amsden, 1989; Weiss, 2000). In the case of Proton, the institutional context also accentuates the reciprocal relationship between the state and firms, but companies have limited freedom to decide strategies including technological advancement (Rasiah, 1997; Rasiah and Jomo, 1999; Samsuri, 2017). The qualitative data reveals that technological development plans and even administrative matters are subject to top political leadership approval. Since Proton is the flagship of Malaysian car manufacturers and the brainchild of Mahathir Mohammad, political interference in Proton became an institutional constraint in terms of technological development. In addition, in many instances Proton appeared to be unprofessional in its decision-making process because the political interference has led to a dictatorial style in leading the company (Awani, 2016).

This centralised decision making on strategies of technological catch up may be a disadvantage for Proton. However, the institutional capacity that structures the power of the political elite can in some ways be an advantageous position for Proton (deemed as national interest) to acquire necessary technology, especially when acquisition of technology involves substantial costs (Rasiah, 1996). Furthermore, given the rapidly changing environment in automotive technology and liberalisation, the role of the state elite can protect the national car company. Learning is also facilitated from protective policy along with access to state resources.

Ever since the limited technological transfer problems occurred between Mitsubishi and Proton, the company (with the assistance of the government) has attempted to increase competitiveness by reducing costs, increasing production, reducing import content and pushing for technological development. The uneasy relationship between the government and Mitsubishi means the government is disillusioned at Japan's reluctance to transfer motor-vehicle technology and concerned at the rising cost of Japanese component imports (NYT, 1994). As reported by Jomo (1994), agreement on technological transfer remains an unclear area between Proton and Mitsubishi. This prompted Proton to venture into new options by forming a strategic alliance with French Car companies Citroen and later Renault. Following the new collaboration, Proton purchased the Citroen AX engine, the cost being 50 per cent cheaper than the Proton Satria 1.3L (hatchback) modelled after Mitsubishi's Mirage/colt. This strategic alliance was made to upgrade the existing technology and put pressure on the Japanese company to ensure there is a proper technology transfer to Proton. After the purchase of Citroen AX, Proton Tiara 1.1 (small compact car) was introduced in 1996. However, the product was poorly conceived, lacked of quality and faced various mechanical problems. Given the rapid pace of technological development, Citroen later replaced the AX with the Saxo engine. Proton was unable to catch up with the development (Tan, 2008), hence this ended the collaboration with the French car manufacturers.

The major development of Proton was the acquisition of British Lotus Group International in 1996. Lotus Group is a British automotive company that specialises in high performance sports cars. The national car company acquired an 80 per cent stake in Lotus Group valued at £50 million. In 2003, Proton's stake increased to 100 per cent. Given the political elite's vested interest in Proton, it is unlikely that the national car company acquired the shares of Lotus Group without special arrangements using substantial government funds to purchase the stake. Yahya Ahmad, a key shareholder of Proton and close friend to Mahathir, was instrumental in purchasing Lotus Group (Reuters, 1996). An interesting point here is that Lotus Group's engineering capabilities focused on luxury sports cars, though Proton was less interested in adding a high-performance sports car to its product line. Instead, their purpose was to import the engineering talent Malaysia could not hope to produce for many years (Dauphinais and Price 1999, p.69). By gaining the majority of stake in the company, Proton was able to gain access to necessary technology upgrading and R&D, which was a major step in upgrading the national car company's engineering capability (Rasiah, 1997).

Proton moved to improve its engineering capabilities with Lotus engineers. Proton improved the Satria 1.8 GTi model and Perdana V6 with 'Lotus-tuning', which were quite well-received in the market. Having access to Lotus technology, the national car company managed to design its own engine named Campro. Such technological upgrading was able to lift the national car company's status to Original Equipment Manufacturing (OEM). The engine was used for Proton's first in-house designs, the Waja and Gen-2 models. The model Waja showed progress, as the company no longer designed its car based on variations of Mitsubishi's Lancer. However, it still used Mitsubishi's (Carisma) chassis (platforms) for which they bought the intellectual property rights. The Waja model increased local content up to 95 per cent. With high local content saving the company from foreign exchange outflows, it imported parts and components namely for the engine and transmission from Japan and Europe. While developing the Proton-owned engine, the company expected to save RM 2,000 per car and RM 500 million on royalty payments (Rashid, 2006; Automotive News, 2004).

Under pressure to release a new model, the Gen-2 model was rushed into production in 2004 with the Campro engine platform. The car suffered from poor design and build though, and a more pressing problem was that the engine suffered from weak torque and Proton was unable to design variable valve timing technology (Autozine, 2005). This reflects slow learning and technological upgrading. However, given the reciprocal relationship between the government and Proton, substantial resources were allocated to support the growth of the local car company. To regain their market share, Proton came out with a few other models and makes to compete in the market. The Prevé model (with Lotus technology) was one of Proton's latest designs intended to capture the global market. The car achieved a 5-Star Safety Rating from the Australasian New Car Assessment Program (ANCAP) (Motor Trader, 2013). Even with this rating, the Prevé model faced difficulty competing in the export market, particularly in the ASEAN region.

Despite the attempt to capture the automotive market, the company has been unable to regain market share in the wider domestic market and export market. This is largely linked to the lack of competitiveness of Proton cars in the automotive market. To regain consumer confidence, the government and Proton re-entered into an agreement with Mitsubishi. With the Japanese company's technical assistance, Proton launched the new Inspira model based on the Mitsubishi Lancer GT 2.0. The Inspira model is rebadging the Japanese car with minimal exterior modification and with 40 per cent local content. Proton also entered into deals with Honda to come out with the Proton Perdana Replacement Model (PRM) with little disclosure of details (Paultan, 2013; Wards, 2013). However, based on the qualitative data, the deal was aimed to improve sales of the Perdana model, which targets the above 1.8cc market segment in which most Japanese auto companies have a strong presence. After signing the deal, Proton came out with new Perdana modelled after the Honda Accord. Based on the qualitative data, this agreement is another rebadging of the Accord model with slight modification that likely involved a substantial cost of purchasing agreement. The Proton-Honda collaboration enabled Proton to use the Honda Accord chassis, but the engine used in the Perdana is based on the eighth-generation Honda Accord engine, which is an outmoded version (Paultan, 2016).

With the strategic role of the state elites behind the national car company, Proton has also ventured into designing a Proton hybrid as part of the initiative under the NAP to encourage Energy Efficient Vehicles (EEV) and meeting the global standard in automotive energy consumption. In 2012, MITI facilitated the transfer of a RM270 million R&D grant through special arrangement with the government and Proton to develop a hybrid car. Proton formed a joint venture with the UK firm Frazer-Nash Research Ltd. The owner of Frazer-Nash, Kamal Siddiqi, is a close friend of Mahathir Mohammad, hence there was no competitive bidding in choosing the research company. Frazer-Nash received full upfront payment without one electric car being delivered (The Star, 2016). Proton was expected to sell an electric car by 2014, though it was reported that the collaboration has not produced a road worthy car because the technology used was not up to the standard (Free Malaysia Today, 2016).

Based on the qualitative interviews, Fraser-Nash is a failed project because collaboration with the company was not the best option, though MITI or even Proton have no final say in this matter. Despite this, the government has used a substantial amount of taxpayer money to finance the project. It is important to note that most global auto manufacturers have geared towards an electric car or hybrid. Volkswagen has set USD10 billion for the next five years to develop an energy efficient and electric car, Toyota's development of the Prius electric model absorbed USD 1 billion for research and development, and Nissan spent USD5.6 billion for its Nissan Leaf electric concept car (Financial Times, 2013; Independent, 2017; Reuters, 2016a). Most of these auto companies already achieved economies of scale and high volume of sales in the world market to support R&D costs for energy efficiency. Economies of scale is linked to capacity for investment in R&D and requires high capital costs to facilitate innovative activities, as even the Chinese car automakers such as like Great Wall, Shanghai Automotive Industry Corporation and Dongfeng had problems financing automotive R&D (Financial Times, 2007; Tham, 2013). The small domestic market (estimated at 700,000 units) which Proton targets in Malaysia's automotive industry is unable to arrive at economies of scale, hence it is unlikely for the national car company to be able to invest in high-tech R&D.

Most foreign automobiles comply to the EURO 5M fuel quality standard. This requires automobile companies to design engines compatible to the EURO 5 fuel standard in order to reduce carbon emissions. The NAP stated that Malaysia is using EURO 2M fuel quality and that gradual changes to its fuel standard will be undertaken. The qualitative data analysis reveals that Malaysia's state-owned enterprise Petronas can meet the global requirement since most imported cars already meet the fuel quality standard. However, Proton remains lagging behind in terms of its engine for exhaust emissions. While most foreign companies demand the European Emission Standard, the role of governing elites has deterred the changes of the fuel standard in meeting the needs for the Proton engine. The Interview data also suggest that upgrading the fuel to EURO 5M involves higher costs for fuel, which will lead to public outcry. Given that the UMNO political elite have undue influence over Petronas (Reuters, 2015; Johson and Mitton, 2001), increase in fuel prices may affect the already-ailing UMNO-led BN's popularity. However, given the pressure from the auto market to export the national car abroad, only recently Proton has invested USD136 million in R&D for a new range of engines, in collaboration with British vehicle engineering firm Ricardo and sports-car manufacturing arm Lotus Group (Automotive Analysis, 2016).

The existing institutional context that supports the reciprocal relationship between Proton and the government to some extent has supported the growth of the national car company. Particularly, owning the majority stake of Lotus Group provided Proton access to Lotus technology and engineering, hence enabling to Proton to upscale their technological capacity. Although Proton has made some advancements in its auto technology, the national auto manufacturer has not entered the automobile technological frontier (Wad and Govindaraju, 2011; Tai and Ku, 2013). Proton still faces ongoing competitiveness problems. The qualitative interview data suggests that acquiring Lotus is not the best option because there is a mismatch between the high-performance sports car manufacturer and Proton that targets the middle and lower end market segment. This mismatch causes a problematic technological transfer to Proton. The national car company has limited freedom to decide its own technological upgrading strategy due to strong political interferences in acquiring Lotus Group. Political influences become institutional constraint for Proton even in the direction of technological planning. This is expected since the company has become so dependent on the government. Technological upgrading is progressing slowly, as reflected in Proton's engineering capacity to develop models with cutting edge technology. This is linked to the ethno-colour policy that gives priority to Bumiputra engineers with less consideration of other groups to participate, and uncompetitive vendors linked to Proton has slowed down its upscaling progress (Rasiah, 2011a). The company strategy (with government directives) to enter into deals with Japanese companies to improve its market share also reflects the upscaling problem because the indigenous technology is unable to produce competitive models in the wider market. In short, the existing institutional arrangements between Proton and the government can facilitate the growth of Proton, but also constrain the national car company by limiting its degree of freedom in deciding company strategy.

6.2.2 Partnership

Acquisition/merger or forming partnership in the automotive industry has become increasingly common with the rise of globalisation for the large automotive corporations. The emergence of the global production network has led to a different division of labour operating in different geographical scales. To utilise the locational advantage, most large automotive corporations attempt to secure and collaborate in the production networks on a global scale. This eventually pushes most corporations to expand and consolidate with other auto firms (Doner et al*.,* 2004; Sturgeon and Florida, 2000). An important consideration in forming partnerships or mergers is partly to benefit from economies of scale, improve cost structures, and expand new space for expansive trade. More crucially, strategic alliance is crucial for auto firms to take advantage of excess production capacity, access to cutting edge technology, intensive R&D activities or joint technical collaboration, and to be able respond to wider export demand at various market segments (Yusuf; 2004; Humphreys et al., 2000). Following the benefits of acquisition and merger, most MNCs have attempted to move into this trend. A few acquisitions and mergers in the automotive industry include Volkswagen that acquired SEAT, Skoda, Porsche, Audi, Bentley, Bugatti and Lamborghini for passenger cars (Volkswagen AG, 2011), and the Renault Nissan Alliance, a Franco-Japanese strategic partnership which controls Dacia, Datsun, Mitsubishi and Lada (Automotive News Europe, 2016). The Groupe PSA (Peugeot Citroen) also controls Opel and Vauxhall Motors (Automotive News, 2017). The TATA group, an Indian MNCs, controls British Jaguar and Land-Rover (Dail Telegraph, 2008), while Chinese Geely Zhejiang acquired Swedish Volvo and other Chinese automobile companies such as Emgrand and Gleagle (NYT, 2010).

In the case of Malaysia, even though the national car company is a full-fledged automotive manufacturer, the lacklustre performance of the company undeniably requires forming foreign strategic partners as a viable strategy to improve its performance. Under the Economic Transformation Plan (ETP) of 2010, which is also stated in the NAP 2014, the current government intends to seek partnership with other global automotive industries (MITI, 2017). Though Proton has been struggling to compete with international marques for almost four decades, this does not mean other global automotive companies are not interested in forming joint ventures or acquiring Proton. Since the ASEAN region is able to produce more than 4 million cars annually and the regional production network (supported by AFTA) provides opportunities for global companies to take advantage of less tariff barriers in automotive production (ASEAN Up, 2017), forming a strategic alliance with Proton enables foreign companies to have access to the ASEAN market. Furthermore, given that the government has invested a substantial amount of resources to build infrastructure, machinery and plants, existing R&D facilities, and marketing and distribution networks (Doner et al., 2004; The Economist, 2004), for foreign companies acquiring Proton would enable them to have access to these existing facilities for further improvement. In turn, Proton would be able to access better technology with foreign partnerships, and by improving the existing technology Proton would be better able to increase its competitiveness. This can address the company's lack of economies of scale. With technical assistance from foreign partners able to improve engineering capability, this could reduce development costs for each model produced by Proton (Reuters, 2016b). Most scholars have pointed out that strategic partnership is essential for the national carmaker to access superior technology, restructure internal management, improve marketing and distribution, and broaden market access (Jomo, 1994, 1993, 2008; Rasiah, 1999, 2006, 2011a; Tham, 2003, 2004b; Tan, 2008; Fleming and Soborg, 2016; Natsuda et al., 2011; Govindaraju, 2010; Wad, 2008; Tong et al., 2012; Irwan, 2017).

Forming foreign partnership is a challenging task for the national carmakers. While forming partnership is part of increasing efficiency for the national car company, it tends to respond to the demand of domestic political pressure. Though the NAP intends to seek partnership to improve the Proton, it is constrained by the institutional context. Unlike mergers or acquisitions of European and Japanese automotive companies that prioritise economic efficiency, those formed by Malaysia's national carmaker are based on nationalist ideals not commercial rationale. It is likely constrained by political considerations that override efficiency of the automotive industry (Natsuda et al., 2013; Doner and Wad, 2014; The Economist, 2004). Pertinent to this regard is that the national car company has been framed as a national interest in which the political elite has vested interest. The national automaker is the flagship of the country, it is the car manufacturing company that has enabled Bumiputra to lead heavy industrial development (Jomo, 2007; Tham, 2014). Such a sense of nationalism, along with the need to protect Bumiputra interest (those vendors depend on the Proton supply chain), has been used as policy discourse by the political elite, and has therefore infused into the policy-making institutions (Whah and Guan, 2015; Milner et al., 2014). The embedded ethno-nationalism has become an institutional constraint in most policy arrangements between actors in devising plans for seeking foreign partnership.

Given such institutional constraint, Proton has never entered into proper strategic partnerships that resulted in foreign automakers having majority share of the national car company or a properly joint collaboration (exception in the case of Mitsubishi in the earlier stage) (Carlist, 2015). Instead, most Proton technical assistance agreements are limited to specific product sharing agreements with foreign companies (The Star 2017). Most of the product sharing agreements are to purchase licenses to use or to copy the foreign companies' technology. As mentioned in the earlier section, product sharing agreements such as purchase licences to share platforms or powertrain entail limited technological transfer because foreign companies will share different levels of technological quality with their partner[44] (Okada, 1988; Tham, 2004b).

However, given the poor performance of the national car company, searching for a strategic alliance seems inevitable in order to improve the company sales, upgrade existing technology, improve marketing capability and expand to the export market (MITI, 2017; Irwan, 2017). Many companies over the past decades have shown interest in acquiring Proton (WSJ, 2004a; The Star, 2017). In 2004, the national carmaker negotiated a possible collaboration with Volkswagen AG of Germany, one of the largest auto carmakers in the world. The intention of Volkwagen to seek partnership with Proton was to enhance Proton's position in the automotive production network, while at the same time enabling Volkswagen to utilise Proton's overcapacity plant in Tanjung Malim (with a 500,000 unit production capacity) to assemble cars for export in the Southeast Asian market, where the German company has limited market share (Athukorala, 2014). The German auto giant intended to use Malaysia as the main production network due to the dominance of Japanese automakers in Thailand. On the other hand, Proton could gain access to Volkswagen's cutting-edge automotive technology, and share research and development and production strategies, in the same way the German company has turned around Czech carmaker, Skoda (Reuters, 2007a). This could improve the national carmaker's technological upgrading and market access in the automotive production network (WSJ, 2004). However, in 2006 the Volkswagen group and the Malaysian government refused to form this strategic partnership (Reuters, 2007a). The Malaysian government ended the partnership talks because they refused to have a foreign company become the major shareholder and take over the management role of Proton.

Another European carmaker, Groupe PSA (Peugot and Citroen), also bid for partnership with the national car company. The intention of the partnership was linked to PSA's five-year plan to develop a strong presence in the Asian region and plan to sell 1 million vehicles in China and Southeast Asia by 2021 (Automotive News Europe, 2016). Similar to Volkswagen, Group PSA intended to use Proton's

[44] For instance, the agreement with Honda to use the Honda Accord's older version Accord engine to improve the Proton Perdana Model. Proton also entered into agreement with Suzuki to share the Suzuki Ertiga platform and powertrain to develop a mini MPV Proton Ertiga.

underutilised production facilities as a production and export base in Southeast Asia, while taking advantage of the regional production network in auto parts and components trade. Having a controlling stake over Proton would enable the French company to broaden access to French auto technology and its subsidiaries such as Vauxhall and Opel. PSA could also broaden market access for Proton. While there are clear potential benefits to collaboration with the French company, the government also decided not to further pursue possible collaboration due to its reluctance to cede control of Proton (Reuters, 2007b; Just-Auto, 2014).

The partnership details of the national car company are rarely available in public, though it was recently reported that there are 20 auto companies that Malaysia has negotiated with over the past decades (Just-Auto, 2016, p.32). Most partnership negotiation seems futile especially in relation to ownership of the national car company. According to P1,

'*Proton resembles our national pride and it is our national car… if it is sold to foreigners who become major shareholder Proton will cease to be a national car…Proton will just be producing foreign cars in Malaysia…that is something we have been doing since the 1970s'.*

This statement shows how a nationalist stance prevented possible collaboration between the national car company and other global auto manufacturers. The qualitative data analysis reveals that partnership talks come to a halt when foreign companies want to become the major shareholder in Proton. However, most global automakers want more ownership, which is common because they are able to control productions and management in accordance with global auto standards, lean productions and robust continuous improvement in R&D activities (Yusuf, 2004). This includes having control over the suppliers-assembler's relationship, particularly the vendors in the supply chain in order to meet the best quality standards. In the case of Proton, political consideration hinders substantial ownership of the company because there are many Bumiputra vendors who depend on the Proton supply chain. Therefore, any foreign ownership can undermine the implementation of the ethno-nationalist policy (Athukorala, 2014). Furthermore, a foreign company with control over the national car company will constitute direct competition of their automobile in Malaysia's domestic automotive market (Reuters, 2007c).

Proton has been the main provider of employment and has improved participation of Bumiputra companies in the automotive industry. As stated in the earlier chapters, Proton has generated more than 200,000 employment opportunities. In relation to this, the challenge of strategic partnership will entail foreign ownership control of Proton's direction and business strategy. This includes selection of vendors and R&D companies in Proton. P1 notes that:

'…once foreign companies have controlling stake over Proton some vendors will be marginalised in the production chains. They (vendors and suppliers) will close shop… lots of workers will lose their jobs and Malaysia's engineering capacity will be reduced… Malaysia will remain a third world developing country…'

This is expected if Proton is acquired by well-established auto makers in meeting a higher quality standard. Based on the qualitative data, strategic partnership is about improving the efficiency of the national car company even though nationalism is valued. However, there is a need to address the ailing national car company which has been draining state resources for decades. Nationalism does not mean anything if the national car is labelled as inferior quality. Some interviewees suggest foreign ownership could further improve vendors linked to Proton. A more professional decision-making environment can make companies more competitive in their productions in order to maintain their place in the supply chain. Partnership can improve the vendors' technological capacity and learning to meet the quality standard of parts and components.

In Proton's most recent development of strategic partnership agreement, the main shareholder, DRB-HICOM, with government directives, has partially divested its Proton shares to Chinese automakers Zhejiang Geely Holding. Following this foreign strategic partnership agreement, Geely will take a 49.9 percent stake in Proton and DRB-HICOM retains a 50.1 percent stake. This agreement also saw that DRB-HICOM divested its Lotus Group share, with Zhejiang Geely acquiring a 51 percent majority stake in the British high-performance carmaker. From this strategic alliance, it is expected that Geely will utilise production capacity and establish a manufacturing hub for Geely right-hand drive models, while Proton will be able to access the Geely platform and technologies, particularly Volvo, since Geely controls a majority stake of the Swedish car company. This first collaboration is to design a new Proton SUV based on the Geely Boyue model. Divesting part of the share may be viable strategy to expand production for the national car company, though qualitative data analysis suggests that the Chinese company is less interested in Proton than it is keen on acquiring Lotus for technological transfer.

The strategic partnership agreement is done, after political tension between Prime Minister Najib and Mahathir. The political disagreement has led Mahathir quit UMNO and resign as Chairman of Proton. Most political analysts point out that this agreement is part of selling Mahathir's legacy. Even though this agreement marks a new direction for Proton, the political elite still respond to domestic political pressure, particularly regarding Bumiputra interest. DRB-HICOM retains a majority share of Proton and the owner of DRB-HICOM, Syed Bukhari, is in the close circle of the Prime Minister. Therefore, Proton is not entirely sold to a foreign company, as the political elite retains influence in the national car company especially relating to Bumiputra interest and the vendors linked to Proton's production chains.

6.3 Conclusion

Industrial policy is in part a function of preferences expressed in the policy-making institutions. Institutional arrangements taking place may produce different industrialisation strategies. In the case of Malaysia's industrial policy on automotive sectors, the government chose an independent mode with the formation of the national car project to pursue its industrial development. The formation of the national car project intended to rationalise the fragmented automotive sectors, but it also holds a nationalistic stance. After the launch of Proton, configuring the national automotive policy has evolved around the interest of the national car project. Given the strategic role of the government in orchestrating the preferences of automotive policy, Malaysia's industrial policy has facilitated the growth of Proton to become a full-fledged car manufacturer.

Over the decades the growth of Proton has been backed by government supports. Despite privatisation and liberalisation in the automotive industry, the national car company remains dependent on government. As the domestic institutions accentuate a reciprocal relationship between Proton and government, the growth of the company is likely subject to the political influences. Proton has less flexibility to decide its own strategy and technological development. Although the national car company can access state preferential resources, political consideration and strong nationalism has compromised its economic reasoning. For this reason, the growth of Proton is limited because the company's strategy and direction are subject to political influences. This has implications on the technological growth of Proton, which affects the competitiveness of the company. The national car company has limited innovative capacity to produce an exportable brand in the broader market. The shrinking domestic market share also indicates that Proton is under constant competitive pressure from other non-national cars. Though there is opportunity to form partnership with other global automotive corporations as part of the company strategy to become integrated in the global auto production network, the government's reluctance to cede management control has hindered strategic alliances. In short, the institutional capacity has allowed the ruling elite to devise automotive policy to promote the growth of Proton since its infancy stage, and such capacity was crucial to promote heavy industrialisation similar to the developmentalist state approach in East Asia. However, in Malaysia, the deeply embedded political influences and the concern over the Bumiputra agenda has hindered the growth of the national car company.

Chapter 7

Political Chicanery and Institutional Arrangements of the National Automotive Policy

7.0 Introduction

The aim of this study is to understand the politics of industrial policy. The case of Malaysia's national automotive policy provides valuable insights on the strategic role of the state elite (politicians and bureaucracy) and industrial groups linked to the state elite to mobilise resources and assert their interest within the policy-making institutions. The role of institutions in Malaysia's context are influenced by historical specificity, power relations, and normative dimensions affecting the interactions between principle actors in configuring the NAP. As such, they have implications on the policy planning and implementation. Institutional arrangements formed by these actors reveal the politics on how actors defend and define interest against the backdrop of pro-market reform in the domestic automotive industry.

This chapter examines the politics behind the configuration of the NAP. The first section will explore Malaysia's political institutions, which are the central place for policy creations. This part describes how political elite manufacture ideas and interest regarding the preference of industrial development. The political institutions dominated by the long serving UMNO-led BN have given the executive branch a dominant role in the policy-making process. What is important to note here is that the formation of the national car projects under the heavy industrialisation programme represents the interest of the political elite. The project has been framed as a national interest with strong emphasis on Bumiputra groups leading the industrial development through the automotive industry. The presence of the national car companies has implications in the configuration of the NAP, particularly in pro-market reforms.

The second section will analyse government-business ties. Such ties reveal how institutional arrangements are made between the government and industrial groups to secure the interest of domestic enterprise in the automotive industry. Given that there is strong ethnic consideration in the development of the automotive industry, the development of domestic enterprises is not akin to the developmental state approach in Northeast Asia where governments are linked to the productive groups in the society. In Malaysia's context, industrial groups are formed by the political elite with the purpose of enabling Bumiputra participation in the automotive industry. Such groups depend heavily on state resources. This section will describe how the existing institutional contexts facilitate the reciprocal relationship between government and domestic enterprises. Typical in the developmentalist state approach, interaction between actors to devise policy goes beyond formal arrangement. Informal rules (patron-client ties) become an important avenue for government and private enterprise to devise ways to obtain access to state rents. At the same time, the informal linkages become ways to adjust and prevent changes in policy. Institutional arrangement formed by the government and domestic enterprise also leads to unusual policy arrangements to secure the interest of the national car companies.

The third section examines the role of bureaucracy in configuring the NAP. The role of bureaucracy in a developmental state is to design policy, channel resources and implement coherent industrial policy. This section discusses the institutional context that underpins politico-bureaucratic ties that affect the role of bureaucracy to plan and implement industrial policy. The strong politico-bureaucratic ties enable the political elite to impose its will onto the state agencies. This leads the pilot agencies in industrial planning to attempt to adjust policy terms in favour of the domestic enterprise, despite how it may affect the overall efficiency of the automotive industry.

The overall analysis here represents the role of institutions in facilitating and constraining actors in the policy-making institutions. Malaysia's institutional context affects configuration of the NAP, in which the triangular arrangement (formal or informal) between the political elite, bureaucracy and 'selected' private enterprises can change aspects of policy or prevent coherent national automotive policy implementation.

7.1 Political Institutions

The political institutions are the heart of policy creation and change. They are the central place where collective ideas and decisions are made. The dynamic of policy formulation depends on the political actors' interactions that are influenced largely by the formal institutions and normative rules of the political institutions they are embedded in (Lowndes, 2010). However, the interaction of the political elite is subject to the balance of power between other political actors. Different institutional contexts may have distributed power unequally, which is rooted from a historical specificities and normative dimension. This can limit groups' participation to advance their interests in the policy domain or to block policy preferences. With an uneven distribution of power, the institutions structure the capacity of the political elite to come out with policy ideas, preferences and strategies (Thelen and Steinmo, 1992). Having control of the policy-making domain, the political elite can mobilise resources and influence formation of industrial policy. Often, political elite frame industrial policy with ideology that is in consonance with the norms and values embedded in the institutions in order to make the policy ideas legitimate.

In the context of Malaysia's political institutions, the long-serving coalition government, UMNO-led BN, plays a dominant role to manufacture policy interest (Chin, 2011; Brown et al., 2003). The uneven power relations of the institutional design enable the political elite to have control over the institutional arrangements in the policy-making process, hence limiting other actors to promote their own interest (Gomez, 2016; Felker, 2015). Most respondents from primary interviews agreed that politicians, especially UMNO senior leaders in the country, have strong leverage in policy making. They suggest that changes in industrial policy or interpretation of preferences are based on the interests and preferences of the political elite. Interpretation often links with nationalistic sentiment and ethnic consideration as part of maintaining political legitimacy. Based on the primary data collection, in general most respondents highlight the role of politicians in configuration of national automotive policy. It is suggested that the politician has final say in national automotive policy decisions, though their preference may not be consistent with the broad objective of economic welfare. Even though the policy was intended to open up the automotive industry, most respondents emphasise that the government has done very little to liberalise the domestic automotive industry. This is clearly linked to the government interest in the national car projects as a source of national pride. Political elite have used this narrative to preserve the industry under national interest. The government thus retains protective measures whether directly or indirectly to support the national car project.

7.1.1 The Elite Agenda Preserving National Interest

The ideas of the national automotive policy reflect the UMNO elite agenda. It was Mahathir Mohammad's vision to diversify the industrial structures through the national car projects. The national car projects are akin to national interest. Any pro-market reforms that undermine the national interest have been hindered by the political elite. The qualitative data findings indicate that the long-serving ruling coalitions have constrained changes in the NAP. Though there have been changes in the NAP, liberalisation of the domestic automotive market has been gradual and limited. According to P1

'…*we can have an open market* in the *automotive industry, but don't be tricked by liberalisation, we have to protect our national interest, the national car is our national interest…all countries protect their industries for various reasons, not to mention Japan, Korea and Taiwan, they also have their ways to protect their interest through certain policy directly or indirectly*…'

Undermining the national car projects is considered threatening to national interest, which has been one of the important factors in driving industrial development. Though the political elite agreed to embrace a liberal market-based approach in the auto industry, according to A3 '*whether you like it or not, the government will always find ways to support the industry because they control the policy agenda'*.

The political elite can manufacture policy interest because the national automotive industry is politically captured, and in turn the elites can use their political power to preserve their interest in the policy. According to C1,

'Look, it is obvious, especially after Mahathir took over the Prime Ministership, economic policy formation including the heavy industrialisation policy to introduce the national car project is controlled by him. Now, Barisan Nasional has also been in the government for so long, so the problem is that they have excessive control over policy agenda, including automotive policy…most policy is based on their ideas and it is not easy for them to change anything related to Proton or to undermine the company…I call this elite captured. Once policy agenda is captured by elites of course any policy, especially industrial policy, will have their interests, well this may be disguised under the country development need and for the good of the people.'

The national automotive policy (NAP) agenda has been captured by the political elite. To a large extent, policy interests in the NAP have been manufactured by the political elite, particularly by Mahathir (even though he is no longer in office, as a Chairman of Proton[45] the former statesman has strong political clout in the automotive agenda). Though the main objective of the NAP is to liberalise and enhance competitiveness in the domestic automotive industry (MITI, 2014), the presence of the national car project in the domestic market may not make it easy for policy makers to adopt a wholesale liberalisation project. As stated in the previous chapter, protecting the national carmaker

[45] Recently, Mahathir has resigned the chairman position, after political tension between himself and the current Prime Minister Najib. Mahathir quit UMNO and formed a new political party, the Malaysian United Indigenous Party.

seems necessary because the company depends upon the domestic market. Also, the local automakers remain behind in terms of quality due to the problems of technological upscaling in the company. Lack of economies of scale causes limited R&D activities, which leads to lack of innovation in the production.

Though liberalisation is key for the national car company to be competitive in the market, qualitative data findings suggest that the UMNO political elite will continue to protect the national car. This is linked to the historical development of the national car projects that hindered policy changes. When the project was introduced in 1985, the UMNO leader at that time, Mahathir Mohammad, envisioned that the national car project would improve industrial development and build deep linkages. This is because car manufacturing activity involves a complex level of production processes, promotes technological advancement and vendor developments, and generates employment. The project was part of Mahathir's strategy to create industrial nationalism, but it goes beyond economic objectives, as the overarching purpose of the national car project is enable the domestic auto firms to lead car manufacturing and more importantly, enable the industry to be led by Bumiputra groups. In other words, Mahathir hijacked the symbol of nationalism that is the national car project with ethnocentrism in order to achieve developmental outcomes. Jomo (1994; 2007) argues that the national car project aims to promote the Bumiputra groups, thus the main beneficiary of the project is the new Bumiputra business groups that emerged despite having little experience in heavy industrial activities.

The interview with A3 reiterates the same claims and further argues that the national car project under heavy industrialisation consolidated UMNO leadership by distributing economic rents to Bumiputra business groups, hence the national car project represents UMNO legitimacy. It is through UMNO that Bumiputra groups are able to lead the country's industrial development (Chin, 2015). As Felker (2015) argues, when economic policy planning is beyond economic reason it is important to recognise that development strategies have been central to the political regime's legitimation, and specifically to the maintenance of the hegemony of UMNO as the dominant party (p.140). The past decision for having national car project and creating Bumiputra industrialist groups have impacted the institutions to structure policy options with regards to the national automotive policy. Changes to the NAP tend to be limited due to the perceived 'national interest' and Bumiputra interest, as Hall and Taylor (1998) and Hattam (1993) argue that 'history matters' in constructing institutions and constraining actor's interactions in policy arrangements. The underlying institutional structures thus restrict the set of policy ideas for change.

Due to the historical development of the national car project under the heavy industrialisation programme, the political elite are constrained by the options embedded in the institutions to introduce change because the historical narrative on the national car project is perceived as national interest. P2 states that,

'*…the moment you introduced a big project like Proton and you don't know the feasibility of the project, plus it requires so many resources to finance the project…the life of Proton will depend so much on the government, especially because we know this car industry at that time is a sunset industry…so they (Proton) will not stop depending on the government, plus Bumiputra business groups depend so much on this project.'*

Based on the literature review, the national car projects represent the ability of the government to manufacture its own automobile led by Bumiputra groups. The formation of local automakers has made Malaysia the only Southeast Asian country able to produce and design its own made-in-Malaysia car. P1 notes that *'we are the only developing country able to make our own car';* hence the national interest is a source of national pride. This has been infused in the policy-making institutions, and policy adjustments to any pro-market reforms are likely to have special arrangements to protect the national car producers. However, the extent to which the project is really a true national interest is a much debated question. According to P2,

'having a national car cannot be associated with national interest. The project has been Mahathir's vision ever since he was the Prime Minister and the project was introduced under his heavy industrialisation programme…to be honest, I was never against the idea of having a heavy industrialisation programme to improve our economy. But as a former Deputy Prime Minister, I don't think having a national car is the will of rakyat.[46] I never supported the idea of having a national car, I disagree with him because we don't have enough resources or a strong industrial base to promote such industry. If we start something like that it will be a waste of resources. Instead, we can focus on something else in which we have an advantage, like resource-based industries, for instance petroleum or electrical and electronics which we are really good at'.

Similarly, political economist scholars like Jomo (1994) and Jayasakaran (1994) argue that Mahathir bypassed the parliament when he wanted to introduce the national car projects. There were no proper discussions of the original project with cabinet members and state bureaucracies. The interview data analysis suggests that the heavy industrialisation programme through the national car projects has been Mahathir's interest to industrialise the country while enabling Bumiputra groups to lead industrial development.

[46] The Malay term rakyat is usually used to refer to Malaysian people.

7.1.2 Protracted Bumiputra Agenda in Automotive Policy

In the context of the automotive policy, the Prime Minister's Office has strong leverage in the policy-making process. The configuration of policy preferences to form a local automaker reflects the political elite's interest. This is common in a state that adopts a developmentalist state approach, where the executive branch has to come out with a development vision to improve industrial development (Moon and Prasad, 1994). The institutional design enables political actors to fend off other political actor's interests, which can undermine the political elite interest. According to P1,

'*when I was the Prime Minister I really wanted to industrialise Malaysia and to do so we needed knowledge, skills and capability to produce and design things…I believe the automotive business can provide this opportunity to our local manufacturers, especially Bumiputra. This may seem ambitious, as a lot of people think we are a developing country, we don't have skills, resources, Malays are stupid and so forth, but I don't want to believe that because we can make a change. This is the reason why I introduced the heavy industrialisation programme and the automotive is one of the sectors I emphasised. Of course, a lot of people disagreed with me when I wanted to introduce Proton but as Prime Minister I have leverage and authority to introduce policy. I used that opportunity and I believe in what I do…Look, I am a medical doctor by background, when I make a decision I will examine all the problem of the illness, like performing diagnosis after identifying everything, then I will come out with the treatment…so when you want to cure a cancer disease you have to remove the cancer cells, it is the same in politics, if you want to do something you have to remove those inhibiting factors in the system in order to implement a policy*'.

This statement shows that the political elite espouses a developmentalist state approach where elites envision industrialising the country and playing a strategic role in policy processes to attain the developmental goal. While the formation of the national car project was crucial to steer industrial development, the policy decision reflects the interest of the elite who have a dominant role in policy-making institutions. Based on P1's statement, it is acknowledged that there were objections to his policy interest by other political actors; however, in order to have his policy accepted it can be argued that the political elite could displace those who were against his vision. There are many instances of his Deputy Prime Minister being forced to resign due to opposing Mahathir's views (Case, 2012). Such executive dominance can fend off opposing political actors or groups, which makes configuration of policy preference based on the elite. This centralises the policy-making process in the Prime Minister Office, as A1 states that during '*Mahathir's time he has changed the policy arrangement in order to implement his vision*'.

The qualitative data suggest that the political elite has used the industrial development as part of the strategy to increase Bumiputra participation in heavy industry. Linking race with economic development is an important discourse for Malaysia's policy-making process to be accepted in the public domain. As the role of institutions shape interpretation for possible courses of action (Campbell, 1997), so 'packaging Bumiputra interest' along with the national car project is a strategy of the political elite to respond to the acceptable norms of the institutional context to pursue industrial development. Since there are a limited number of Bumiputra groups participating in heavy industrial activity, incorporating their interest is seen as crucial for political actors to increase their participation. Interpreting industrial policy with ethnic sentiment enables the political elite to convince the public about the importance of the project (Tham, 2014), including obtaining support from the right wing UMNO groups. In this way the 'interpretive frame' within the institutional context enables the ruling elite to prioritise their preferences despite there being dissenting views. Incorporating Bumiputra interest has been an accepted convention in policy configuration, including in the national automotive policy (Ibid, 2014). The racial aspect has become common in policy-making discourse since the formation of the NEP. The NEP has changed the 'rules of game' in the political institutions, where the state is likely to take the role of facilitating Bumiputra in the mainstream of economic development. Such changes form path dependence[47], as political actors have vested substantial interest in Bumiputra development, making it difficult to reverse the policy. The overarching purpose of forming the national car project is for the development of Bumiputra groups in the car manufacturing industry, as P1 states that,

'the national car project is always associated with Bumiputra development. The government gives Proton to Bumiputra to handle because without Proton most Bumiputra will remain doing paperwork…they may be an engineer, a qualified one, but they will just stay in the office, they will not get their hands dirty and learn new skills. With this company, the majority of the workers are Bumiputra, the purpose being we want to convince Bumiputra they also can do work just like others in developed countries. If you don't give them this chance through Proton, then they will always work for others and they will believe that they can't do it.

The national automotive policy has a 'locked-in'[48] effect with the Bumiputra agenda: since institutions structure policy choices, the political elite could not ignore the Bumiputra agenda in policy making. The affirmative action policy has thus been in place for more than 30 years. It is inevitable for race and economic interests to encompass Malaysia's policy-making institutions (Milner et al., 2014). A

[47] Institutional arrangements made by actors in the past that can potentially affect outcomes at a later time (Pierson, 1993). Once path dependence exists, it is difficult for political actors to reverse the decision because they have created vast interest in a particular policy and will fight to maintain those interests (Dobbin, 1994).
[48] North (1990) describes the term akin to path dependency. What has been decided in the past may have unexpectedly long-term and inefficient consequences.

voluminous amount of literature highlights that the Bumiputra agenda is no longer relevant because it hinders significant policy changes to promote competitiveness. Gomez and Premdas (2012) frame it as 'institutional decline,' as affirmative action like the ethno-economic agenda leads to poor and unmeritocratic quality policy making. Furthermore, it has been the interpretative frame for most industrial policy, representing the UMNO-led BN's legitimacy to stay in power. It is also the source of the patronage system embedded in policy making that can potentially hinder policy changes. While most respondents agreed that the Bumiputra agenda needs to be reassessed in economic policy-making, some respondents contend that the protracted Bumiputra policy remains valid and necessary. B5 observed that,

'*though there is a move to reassess the need for the Bumiputra policy the policy is still relevant…there is a need to look after their welfare…the government has to fit the affirmative action policy into the current industrial policy because some are still lagging behind in economic activities…'*

The interview with C3 also emphasises that,

'Bumiputra policy is our right…imagine before 1969 the Bumiputra were so far behind in anything. It is because of the policy that so many Bumiputra became better off…so in relation to automotive policy, the government needs to consider our interest'.

Commenting on the same issues, B2 states,

'the Bumiputra policy has a problem, I don't deny that, but we need to help the Bumiputra groups, especially in the automotive industry which is our national mission. However, to be fair, you can't blame Bumiputra policy because the intention of the policy has always been good for the country's developments and industrial development. In actual fact, non-Bumiputra also benefited from the policy…'

The above statements show that the affirmative action policy has been deeply embedded in the policy-making institutions. The presence of affirmative action is thus akin to the state playing a strategic role in facilitating certain groups in the marketplace. Though there are pro-market reforms in the automotive industry in Malaysia, given the need to meet the Bumiputra policy in automotive industry, the government continues to play an active role to provide preferential access to Bumiputra groups. This hinders the growth of the competitive automotive market environment. However, the national automotive policy retains the Bumiputra agenda as an important objective to facilitate the growth of this group in the value chain of the automotive industry. B7 notes that, *'The national automotive policy still emphasises the Bumiputra agenda, especially the vendor development…we all know this is the national mission…currently there is only a 33% Bumiputra contribution in the automotive industry…this number has to increase more, this is the reason we still emphasise the agenda'.*

The interview with C5 stresses,

'We still want to fulfil the national Bumiputra agenda, so special assistance must be given to them…I will continue to support this national agenda'.

Pro-market reform in domestic automotive industries is constrained by Bumiputra policy. This embedded convention has a significant ideology for political elites to interpret the national automotive policy. An analysis of the interview data suggests that policy making in Malaysia is unable to detach from the Bumiputra policy, especially under such a long-serving ruling coalition. Since the NEP was introduced in the 1970s the ruling coalition began to incorporate the Bumiputra interest in economic policy; hence, the historical economic development in Malaysia is likely to relate with identification of race in the current configuration of economic policy. Bumiputra policy becomes precedent in government policy, including in the national automotive industry. Due to the early policy discourse focused on allowing the Bumiputra to lead heavy industrialisation, to date the national automotive policy remains ingrained in the indigenous group's interest ever since the made-in-Malaysia car was introduced. As C9 states,

*'this Bumiputra policy has been there for so long, I don't know why it is still relevant, but it is just the way it works for Malaysia's politician*s'.

C1 added that 'everything is *Bumiputranise'*. In general, most of the respondents agreed that the affirmative action policy has been taken for granted in policy-making process. It is also framed by elites as a way to preserve the national car company and the vendor links to the company. In many partnership agreements between Proton and foreign auto companies such as Volkwagen, negotiations tend to come to a halt because the government refuses to drop the Bumiputra policy in vendor selections.

7.2 Government-Private Relationships

Typically in a developmentalist state approach, the state takes the developmental functions and leads industrial development (Abbott, 2004). The state devises a strategic economic plan setting substantive socio-economic goals and structures domestic industry with the intention to improve national economic growth. In such economies the state does not downplay the role of the market to improve domestic economy, but market entry is structured to enable the domestic firms to grow. Though firms depend on the market to grow, the role of institutions facilitates reciprocal relations between the government and selected private enterprises. As Abott (2004) and Jomo (2004) argue, Malaysia's industrial policy is to promote indigenous firms to grow. The political elite will facilitate the 'selected few' private enterprises in the marketplace to meet the industrial development preferences. The existing institutional design that enables reciprocal relationships allows government and business enterprises to engage in institutional arrangements to devise policy, allowing the firms to have preferential access to state resources.

The reciprocal relationship between the state and market enables informal arrangements between state elites and private sector groups who are linked to the elites. As such, the role of institutions encourages policy elites to engage in collective decision making between selected business groups. Hall and Soskise (2001) argue that such deliberation enables them to share information and strategies in the market institutions. It reduces collective actions problems in competing for resources in certain sectors between other economic actors. This facilitates the allocation of resources, thus increasing cooperation between elites and business groups in focusing on the development of a strategic sector (ibid, 2001). The growth of industrial development in Northeast Asia and Southeast Asia has largely depended on the reciprocal interaction between state elites and business groups (Amsden, 2001). In the context of Malaysia, there is a close relationship between the government and business groups. This close-knit tie between ruling elites and business groups forms an interlocking interest between elites in deciding policy preferences, particularly in automotive sectors.

In a typical developmental state approach, the government collaborates with existing private enterprise by specifying a developmental target and forming institutional arrangements for selected enterprises to have access to state resources. The reciprocal relationship clearly aims to improve industrial development with less political considerations (Jomo, 2004; Abbott, 2003). In the context of Malaysia, collaboration between government-private enterprise is embedded with political objectives. During the implementation of the heavy industrial programme and followed by the privatisation programme, Mahathir's intention was to create a Bumiputra commercial and industrial class to lead the country's national automotive industry. The interview with A3 suggests that though there are well-established existing companies linked to the automotive production network including Boon Siew, Oriental and Tan Chong Nissan, they were not incorporated into the ancillary firms for the national car projects. Proton and Perodua were established to create Bumiputra vendors though they had little presence or experience in the industry. The formation of the national car projects with the intention to create Bumiputra industrial groups formed a reciprocal relationship between government and private enterprises, and such groups are heavily reliant on state resources.

Most of the respondents revealed that close reciprocal relationships between the government and selected enterprises are crucial for the late industrialising country to form cooperation when the country started its own automotive industry. The national automotive industry required substantial resources to push the domestic firms to grow. Therefore, cooperation between the state and firms was needed to improve strategic industry. While the analysis of the interview data suggests that reciprocal relationships are important to promote the national automotive industry, most respondents reiterated that the close relationship tended to go beyond economic objectives. Certain aspects of the NAP are unable to be removed due to strong political pressures and their business allies. Based on the interview data drawn, respondents agreed that even though the national car producers and their vendors operate as private entities in the market, the deeply embedded patronage system makes it easier for the government and the local auto firms to form special arrangements (usually through informal arrangement) behind closed doors to protect the firms under the rubric of national pride.

7.2.1 Patron-client network

The qualitative data analysis suggests that the patron-client network is ingrained in Malaysia's policy arrangements, including in the configuration of the national automotive policy. Especially after implementation of the NEP, the government policy arrangements for the national automotive industry have tended towards subsidies and protecting the local automotive business. Policy configuration has also aimed to distribute patronage to certain 'selected few' groups to lead the industrial development in the country. Though there are pro-market reforms, the political elite tend to provide access to resources for the national car producers due to the dominant role of the elite in the policy-making process. According to A2,

'*…patronage in Malaysia is inevitable when the government has wanted to industrialise the country ever since the introduction of the NEP…the BN government generates rents for the industry to ensure there are sufficient resources for the automotive sector to grow…'*

He explains that one of the features in Malaysia's industrial development is based on state patronage, where political leaders play a strategic role to allocate resources. Respondent A2 further suggests that,

'the *patron client network is like a form* of c*ooperation which is likely to solve distributive issues and facilitate the exchange of resources which, to a certain extent, is better than market mechanisms. This happens in Northeast Asia when the political leaders want to industrialise the country'.*

Khan's (1998) analysis on industrial development in Korea reveals that informal arrangements through the patron-client network are one way to promote *'chaebols'* to having access to resources such as subsidies, loans, and research and development grants, including exchange of information to adjust economic policy that somehow favours the domestic firms in the market. Similarly, Jomo and Wee (2014) point out that thee heavy industrialisation programme in Malaysia adopts the same approach to enable a 'selected few' companies like Proton and Perodua to lead the automotive sectors. Close relationships between the government and the domestic automotive companies enables them to cooperate and devise ways to have preferential access to state resources. Respondent A2 adds that,

'as much as cooperation is crucial, the problem arises when there is 'collusion', or the intention of cooperation filled with political purpose, and the network intention is profiteering…less attention is given to improve the quality of the national car. This is inevitable, given that UMNO is a dominant actor in policy making.'

Respondent A2 describes that the problem with industrial development through the automotive industry is that cooperation has turned into 'collusion', where close ties between elites and domestic auto companies attempt to ensure mutual benefits and that both interests are secured, despite the fact that policy arrangement has a significant impact on the market. The elites' interest rigs the efficiency of allocation of resources, which leads to negative implications on the overall welfare at the expense of the taxpayers. This corresponds to the Penang Institute studies (2017), which show that the NAP does not have significant impact on market liberalisation. While market liberalisation features a competitive market, in Malaysia's automotive market the consumers continue to pay higher prices for CBUs and CKDs due to the excise duties and other informal arrangements made by the government to protect the national car project that distort market competition. Most revenue obtained from the duties is channelled to finance the national car project with lack of public scrutiny.

Most respondents stress that the approach of industrialising the country through the automotive industry has impacted the configuration of the national automotive policy, because the creation of automotive industry was not merely intended to form national pride but it was also embedded with political intentions to create economic rents. P2 notes that,

'*the national car industry is constructed to create rent for the Bumiputra group and this group will also be dependent on the government'.*

Similarly, B1 reveals that,

'*we [government] have to pay so much to finance this project and 'certain groups' associated with the project…this car project is like a moving train with limited rail… we have to keep on building it…*'

The growth of the national car producers and its vendors heavily depends on the economic rents (subsidies, loans and grants), as Lubeck (1992) argues that the Malaysian industrial development has spawned a powerful rentier class. According to C1,

'*the rent-seeking behaviour has reinforced a strong patron-client network between the elites and private enterprises'*.

Similarly, respondent A1 reiterates that,

the patron-client network is part of our culture, it is how it is in Malaysian policy making, especially in the automotive industry where most of the players in the industry are created by elites…it goes without saying: Proton and the Bumiputra vendors'.

Furthermore, the domination of UMNO-led BN in the policy-making process deepens the patronage system, as such significant changes in the NAP can be hindered by the powerful patron-client network. This is because the elites will not let the competitive environment threaten the politically linked individuals who depend on the national car business, including the domestic automotive production network that the local vendors depend upon.

The interview with A3 points out that,

‘the *automotive industry is a political creation with political objectives, it is true that the industry does have the ability to develop new industrial sectors, skills, research and development, and so forth…but the creation of Proton (and later Perodua) depends so much on government funds…though it is important to open up the automotive industry, the government somewhere or somehow will find ways to support the industry…*’

It can be argued that the patron-client network embedded in the policy-making process is part of the informal institutions that shape and constrain policy actors’ interactions. The informal rules can affect how elites interpret policy outcome and provide a continuity element in policy change (Campbell, 1997a; Helmke and Levitsky, 2004). In this case, the national car project are embedded with political interests even though the local auto companies have been privatised. They continue to receive various financial support through beyond arm’s length institutional arrangements.

The findings suggest that although the NAP seeks to create a level playing field in the marketplace, the government tends to facilitate the national car producers in many ways. Respondent A1 says that *‘funds received by Proton for over four decades is a patron-client in action’*. This is a reasonable point because the company has been an important source for industrialisation and Bumiputra vendor developments. The qualitative data reveals that over the years the national car producers have received more than RM14 billion in grants and other forms of assistance to maintain the company. The findings also suggest that the national car producers receive a RM200 million R&D grant annually with little known about it by the public. Recently the Prime Minister has announced another financial support for Proton in the form of a RM 1.5 billion loan. The Prime Minister has explicitly said that this financial support is not a bailout plan but ‘soft loan’ to support the national interest (News Strait Times, 2016). The decision to pass the loan has bypassed the parliament, as noted by some of the respondents who are members of parliaments who have disagreed with the agenda. However, the Prime Minister’s Office has made the decision to pass the loan.

The interview with B1 notes that the government has no choice but to support the automotive industry because politicians have so much vested interest in the national car producers. B1 further emphasises that ‘the *national car project is Mahathir’s baby, he created the national car, and he is also the chairman of the company*[49]’. In this sense, there are many ‘special treatments’ the domestic car company receives. The national car company has received various loans, but it is not known or remains unclear whether the company has repaid the government.

[49] Mahathir has recently resigned from the chairman position after this research was conducted.

The institutional design underpinning the patronage system encourages informal arrangements and discussions between elites and private enterprises. There are many special treatments for the national car producers that have taken place between the elites and the head of the companies through informal ties. C2 notes that '*we will engage in informal discussion with the minister in regard to Proton'*. He also points out that there is a need to ensure the company interest is not threatened by liberalisation, because the company provides various business opportunities in manufacturing activities. He reiterates that government support is essential. For example, the recent decision to offer the soft loan to Proton was to support the firms due to lack of economies of scales given the shrinking of the market share and debts incurred from procurement from local vendors. C2 mentioned that '*if it is not the government who wants to help our people…? There are so many people depending on the businesses'.* In addition, the national carmakers are the national interest, so the need for special treatment in the policy is undoubtedly important to sustain the company in the domestic automotive market.

Informal ties between the elites and the local auto companies have taken place through informal negotiations to adjust policy terms, among other special considerations in terms of tax payments. Based on the interview analysis, due to the interlocking interest between the elites and the national car company both parties tend to negotiate payable tax, and at times the national car companies (especially Proton) may not necessarily pay the actual tax that they owe. This is manoeuvred in opaque ways. However, in interviews with P1, C7 and C8 they indicate that the national car companies have paid taxes and contribute substantially to the automotive industry, such as through research and development. P1 further stresses that Proton has contributed RM24 billion to the government through tax. However, the qualitative data analysis suggests that there is always special consideration for the national carmakers for tax exemptions. Though the local auto company has contributed to the government's coffers in some ways, B1 states that Proton is protected in various direct and indirect ways, and that all the financial contributions are channelled back to the national carmakers through various grants and loans. This is one of the reasonable ways for the government to enable the local car company to continue in the automotive business, despite the fact that it compromises good business governance.

As stated earlier, there are existing funds in the NAP that intend to facilitate the automotive industry. The extent to which the allocation of funds is transparent remains unclear given the presence of patronage systems. Segawa et al. (2016) argues that these funds are tailored to facilitate the national car projects and their vendors, pointing out that the Proton Vendor Association and Perodua Vendor

Association are likely to obtain those funds. Insights from the interview analysis reveal that those funds can be disguised as a form of subsidies, and that clearly such subsidies are intended to support the local auto company and vendors. For instance, C11 mentioned that Proton vendors are likely to obtain more funds because of the need to upscale the current technology for Proton to obtain better quality parts and components. Abdullah et al. (2008) reveal that the national car producers like Proton have 'strict' requirements to procure local auto kits and components as imposed by the government. Though this is part of the strategy to maintain high local content, one of the main criteria in the decision to select vendors is based on equity and ownership of the vendors. Usually, local vendors that have close links with Proton will be chosen.

Some respondents imply that the patron-client network is important to support the local automotive industry, as C8 and C7 indirectly agreed that a close network is used to help local vendors attain economies of scale. C7 mentions that there is a need to provide opportunity to selected vendors '*so they can get loans, make investments to improve technology, learn more and improve the company profile*…' Close-ties provide flexibility for Proton and other vendors to negotiate terms and conditions of the procurement and technology requirements. Focusing on certain vendors provides more opportunity for the company to grow, because they able to engage in the ongoing business with the national car production networks. C8 says that some vendors engaged in the national car supply chain such as Ingress, Sapura, and Delloyd have improved their auto kits production over the years. The opportunity to learn and improve auto parts production through the national car supply chain enables the vendors to supply to foreign auto companies.

An interesting point by P1 reveals that the national car company needs to focus on certain vendors. He states that,

'local vendors need volume to reduce costs, even if the cost is higher. The national car company (Proton) needs to help them so they can be productive in the long run…by helping them so, we hope they can export and also link to other auto companies'.

However, some vendors use the close ties to capture the rents generated by Proton, as the findings suggest that some of the vendors have taken advantage to get preferential access to the designated funds under the NAP. Though the economic rent is to foster learning for vendors to grow and improve productivity, Tham (2014) argues that there is no proper technological upgrading progress or upscaling effort. Evidence of high import intermediate and capital goods in transport and equipment shows the vendors remain heavily reliant on imported parts and components. Furthermore, the poor quality of the national carmakers, especially Proton, are linked to the vendors who are incapable of moving up the automotive production chains, even though these vendors have captured the rents through informal ties in Proton's vendor selection process.

The patron-client network appears to be a pervasive practice in automotive policy arrangements. The qualitative data reveals that the reason this network is deeply embedded in the institutional arrangements is due to the Bumiputra agenda. Most respondents stress that this ethnic-coloured policy impacts the policy configuration of the NAP. According to P3, the Bumiputra agenda has made the automotive industry illiberal and has led to poor automotive development. As stated earlier, the Bumiputra agenda has a locked-in effect in the policy-making process, and the national car projects are associated with the growth of the Bumiputra community in manufacturing activities. The automotive policy agenda is linked to create a 'selected few Bumiputra', which is dubbed as the Bumiputra Commercial and Industrial Community (BCIC). Policy-making thus tends to create economic rents for certain Bumiputra groups but not all, because the main beneficiaries are usually those Bumiputra who have close connections with political elites. The presence of affirmative action in the automotive industry continues to strengthen the patronage system, as A1 and C1 agree that rent-seeking is part of political life in Malaysia's policy-making process.

The findings also suggest that the presence of an ethno-economic policy makes the patronage system unavoidable in Malaysia's institutional setting. However, the interview with P1 indicates that the automotive industry does not intend to promote a clientelist approach, but rather to promote overall Bumiputra participation in manufacturing activities. However, P2 notes that the automotive industry is aimed at allowing selected Bumiputra groups to lead the industrialisation programme, and he states that this has a detrimental effect in policy making because it creates room for patronage. So, though the automotive industry is said to have adopted open market competition, because of the Bumiputra agenda the government continues the ongoing supports for the national car project and it vendors. A3 suggests that patronage system in Malaysia has deteriorated the quality of policy-making institutions. The primary reason for this is that the patronage system, coloured by race, has been captured by the political elite to maintain their preferences in the policy. He states,

'how can policy produce a level playing field if the state's intention is to favour a certain race? Of course not…Proton is an obvious case of interlocking interest between the government and the company…the vendor development programme under the national car project is a good example of a patronage system…'

Institutional arrangements revolve around the patronage system with strong racial considerations hindering significant NAP reforms. Tham (2014) claims that navigating between economic policy and the race paradigm becomes more complex because of the emergence of rent seeker demands for protections at the same time the trade policy commitment was made by the government requiring pro-market reforms (p.190). As stated in chapter 5, the Approve Permits (AP) are one of the contentious policies in the NAP that the government has been unable to do away with. Since the NAP was introduced in 2006, there has been an attempt to abolish the policy but efforts to do so seem futile. While the government scheduled AP to be removed in 2010, the policy was continued until 201, and the most recent revision of the NAP stated that the government would continue the AP system until 2017. An AP is a license issued by the government to individuals to sell imported CBUs with no local contents. AP is akin to the import quota and the permits are often given to Bumiputra.

The initial intention of the AP was to facilitate Bumiputra participation in the automotive business after the implementation of NAP, according to P2

'this policy was devised with an intention to increase Bumiputra vendors to sell used imported CBUs…of course such permits in the long run do not help the Bumiputra to be efficient'.

Tham (2014) and Tan (2015) argue that the AP is an unproductive rent because it does not nurture learning in manufacturing activities. The permit only creates rent-seeking Bumiputra entrepreneurs who engage automotive trading in a protected market. Most respondents reveal that the AP system has distorted the domestic automotive market. Various attempts by the foreign auto companies (for example Toyota), along with other business associations such as the Malaysia Automotive Association and the Malaysia International Chamber of Commerce, have demanded changes to the existing AP system. The permit does not provide a level playing field for foreign auto companies because the AP holders obtain lucrative custom tax exemptions. According to C9,

'An AP holder can bring in a luxury car with full specifications 40% cheaper as compared to a new car. The AP holder also pays less custom tax as compared to the franchise companies like us, which have to pay more excise duty…surely the customer will choose from AP vendors'.

Based on the interview data, the government continues to retain the AP systems, according to C3 who firmly stresses that,

'The AP system is a privilege for Bumiputra, AP has given vast opportunities to enable Bumiputra to take part in the automotive business. Over the years the AP holders have grown so much in the

automotive sectors and have created a Bumiputra business community…the policy enabled Bumiputra businesses to diversity from automotive trading to other investments, such as property development, tourism, etc.'.

P1 noted that despite having some reservations on the AP system, he undeniably agrees that it has been instrumental in giving rise to Bumiputra entrepreneurs. He provides the example of NAZA Motors as a successful Bumiputra entrepreneur who has used the AP system to grow their business. The founder of NAZA Motors, the late Tan Sri S M Nasimuddin S M Amin, has a close connection with UMNO leaders and has been identified as the largest AP holder that is non-transferrable and non-restrictive, which thus used the AP to import any brand of car (Lim, 2005). Mahathir's son is also one of the AP holders able to import the luxury sport car Porsche to Malaysia (though he sold to Sime Darby in 2010) (The Star, 2010). Major recipients of the APs, such as Syed Azman Syed Ibrahim, Mohd. Haniff Abd Aziz and Azzuddin Ahmad, collectively received 15,759 APs. These individuals have close connections with Rafidah Aziz, who was then Minister for MITI (1987 – 2008) (The Sun Daily, 2016). Based on the qualitative data analysis, some AP holders have misused permits for self-enriching purposes. The AP permit can cost at average RM30,000 per permit because the right to import CBUs can generate high income in the protected automotive market of Malaysia, so demand to obtain the AP permits is competitive. It is reported that there are some AP holders who sold their permit to get quick money.

The AP system is difficult to remove due to political patronage. P2 mentions that '*most AP holders are UMNO members and others who are closely connected to UMNO elites*'. An interesting point raised by B1 is that some non-Bumiputra also benefited from AP by having joint ventures with Bumiputra individuals. Given that UMNO elites have a dominant role in the policy-making process, APs are part of economic rents that can be a windfall gain for recipients who obtains the permit quota; therefore, this reinforces political patronage in the policy-making institutions (Tan, 2015). The political patronage is to secure political base support for the elites who have control over the permit quota, not only of the Bumiputra business community but also of other politically linked individuals. This was revealed as most of the respondents suggest that AP holders are the main political financier during election times and have strong political clout. Furthermore, most politicians buy cars from AP holders who offer a cheaper price than the market, so it is difficult to deal with the AP holder groups of producers who have strong political connections with UMNO leaders. It is obvious that the government is unable to remove the AP system because the patronage system is embedded with racial lines. It is difficult to initiate policy change in the NAP because the AP system can potentially undermine the ties between elites and AP holders.

7.2.2 Unusual Policy Arrangement

The policy arrangement revolves around the NAP attempts to protect the national carmakers. The policy changes can alter old rules to form new ones and re-interpret old rules in policy arrangements to preserve the domestic automotive industry. Given that the UMNO-led BN in Malaysia governs the interactions of policy actors, especially in formulating automotive policy, mobilisation of resources and preferences will be carried out in favour of the national car interest. Furthermore, the interactions between policy actors in Malaysia are supported by informal institutions (for example, the patronage system) which facilitate the interactions between elites and their business allies. This provides the elites the ability to come out with unusual policy arrangements through formal and informal institutional arrangements to protect their interest in the NAP.

Pro-market reforms in Malaysia's domestic automotive industry are an inevitable phenomenon. The state commitments to liberalise the automotive industry under the AFTA and WTO show that the country is obliged to support a market-based economy to promote a business-friendly environment. Although progressive liberalisation of the domestic automotive market has taken place since 2006, elites' vested interests in the national car projects have prompted policy makers to come out with unusual policy arrangements to secure the national interest. Based on the interview data analysis, most respondents reveal that there are various unusual arrangements made by policy makers to secure the interest of the national car projects and other interests linked to the elites. This creates an unequal playing field environment in the domestic automotive market.

Given the strategic role of the elites in the policy-making domain, institutional arrangements among the political elite and local car manufacturers have taken place to determine prices in the market. To this end, a price mechanism is used to set higher prices for imported CBUs to protect the national cars. B1 indicates that car prices in Malaysia are determined by the government under a 'gazetted price' mechanism which is little known by the public. In general, setting up prices for imported cars is allowable under the WTO members' government (WTO, 2017). Each make and model of CBUs is subject to custom valuation, which is calculated based on an invoice price that includes the cost, insurance and freight charges (CIF) (Custom Act, 1967), after which the CIF will add on import duty (MFN is 30% while AFTA is 0%), excise duty (depending on engine capacity) and finally sales tax (10%).

Under the provision of WTO custom valuation, it is required to be done in a transparent manner, meaning there should be a clear custom valuation for each make, model and trim, though the extent to which this is done in Malaysia remains opaque (Paultan, 2006). Based on the literature review, the government can influence the price of a car through 'docket price', which is the price custom values of the car companies bring in and applying the designated excise duties rather than following the value state on the invoice (Penang Research Institute, 2017). How the government determine the docket price remains unclear. Since the government can influence car prices, some companies can obtain lower 'docket price', for instance, recently Mazda was able to obtain a 'docket price' reduction to sell their car in the market. Certain foreign companies are given lower 'docket prices' and some incentives (like tax breaks) because they offer value added activities in the automotive sector such as research and development and vendor development in Malaysia (Paultan, 2014).

This research was unable to obtain further details on how custom valuation is done in Malaysia due to the sensitivity of the information; however, setting up the price mechanism is part of the institutional arrangements made by the policy elite to protect the domestic automotive market. Based on the literature review, the reason to come out with a 'docket price' for certain foreign cars is because the cost of production for Proton and Perodua is relatively high as compared to well-established foreign car manufacturers like Toyota and Honda. The obvious reason for this is that the national car producers, especially Proton, are unable to attain economies of scale. Proton has a 350,000 production capacity but the company annual sales rarely surpass 200,000 units per annum. Due to this low sale volume, Proton struggles to attain cost efficiency. Furthermore, without economies of scale it is unable to support the comprehensive R&D programmes needed by local car companies to upgrade technology as required by fast-moving automotive markets (Justauto, 2014). Poor export performance makes the company target sales in the domestic market to maintain its production.

The qualitative data analysis shows that besides using opaque customs valuations to inflate foreign cars, the government also determines car prices for certain models. This policy arrangement takes place in the national economic council, which is the highest body of the economic policy decisions in the country. Imported CBUs or CKDs with an engine capacity of 1800cc must be sold above RM150,000 in the market. Given the non-national cars (Honda and Toyota) are more competitive and the cost of production is lower than the national car, B1 states that in a level playing field environment, the non-national cars can easily drive out the national car in the market without price setting. As such, determining prices is intended to mitigate threats to the national cars in the marketplace. Fong (2011) points out the adverse impact of protecting the local automotive market, as it has made prices for imported cars substantially higher, in fact higher than in the rest of the world. The determination of car prices for imported cars is an unusual policy arrangement to protect the national carmakers. B1 suggests that '*such practices* are *clearly inconsistent with the WTO anti-competition principle that is* *fair competition*.' Based on the principle of national treatments, imported vehicles and locally produced vehicles should be treated equally, though setting higher prices for imported CBUs and CKDs violates this principle. However, there is no complaint being lodged by foreign automakers, as B1 states that in such policy arrangements the foreign automakers benefit in Malaysia's automotive market because determining prices for certain models resulted in an increase in non-national car profit margins. Even though the price is higher for non-national cars (especially Japanese cars), due the 'aspirational value' consumers with a higher purchasing power are willing to pay more for non-national cars (livelifedrive, 2013).

As stated earlier in this chapter, customised incentives under the NAP are among other ways for the government to encourage foreign auto companies to build linkages for local vendors in the automotive supply chain. Auto companies procure from local vendors benefit from excise duty reductions based on values of the local content. Most respondents reveal that the customised incentive under the NAP is not transparent and most automakers are unsure of the actual exemption given by the government. In comparing Thailand's customised incentive and Malaysia, Thailand has made clear provision of incentives for foreign automakers. For example, under the Thai Eco Car Policy, auto companies that procure auto kits and parts from local firms are qualified to obtain an excise tax reduction to 17 percent (down from 30 percent) and an eight-year tax holiday. In contrast, under the NAP customised incentives refer to various tax breaks, soft loans and R&D for car companies who buy from local vendors. Though the policy states there are incentives for Energy Efficient Vehicles (EEV)[50], but the extent to which companies can obtain actual exemption for EEV incentives remains unclear. Based on the interview data analysis, respondents indicate that there are unusual arrangements by policy makers for auto companies to qualify for customised incentives. Most respondents reveal that the foreign automakers are eligible for the customised incentives. Since there is unclear information about the incentive, to qualify for it 'special negotiations' will be place between the MITI and the companies. Different provision of incentives is given to different auto companies depending on the negotiations. Respondents claim that there is lack of transparency in the terms of conditions for the incentives, which leaves room for discretion among policy makers to come out with conditions for incentives.

An interesting point suggested by the respondents is that customised incentives to reduce excise duty usually requires procuring auto kits from the local vendors. The selection of local vendors is usually determined by the federal agencies, in this case the Ministry of Finance. There are lists of 'selected

[50] The NAP states that EEV are defined as vehicles that meet a set of specifications in terms of carbon emission levels. This includes fuel efficient internal combustion engine hybrid, electric vehicles, and alternative-fuelled vehicles such as Compressed Natural Gas (CNG), Liquefied Petroluem Gas (LPG), Biodiesel, Ethanol, Hydrogen and fuel cell (NAP, 2016, p.7).

local vendors' suggested by the federal agencies to obtain customised incentives for excise duties reductions. The findings suggest that this unusual arrangement is made to facilitate the local vendors (not all local vendors but those who have good links with senior officials in the Ministry). It is clear that when the company increases local contents more incentive will be given. However, sometimes there are parts that are not available in the country, and some companies will arrange with local vendors to import the parts then supply the part back to the OEMs. The interview data reveals that there is no strict enforcement or monitoring process from the Ministry, so such arrangements can be easily made for foreign and local companies. This is an easy way to get tax break incentives from the government.

7.3 Bureaucracy

In a developmentalist state approach the state bureaucracy plays a crucial role in policy planning and implementation. The bureaucracy devises policy (long or short term) for domestic enterprises to grow in the marketplace. The state's institutions are responsible for allocating resources in a way that facilitates domestic enterprise. Constant adjustment of the terms of policy responds to the market environment through institutional arrangements with firms and political actors. The effectiveness of the bureaucracy to plan and enforce economic rules depends on the political institutions insulating the bureaucracy from private demands or other social forces such as peak organisations. Insulation enables technocrats to have a certain degree of freedom to act independently. Deliberation can be done effectively with less political or private interference (Thurbon and Weiss, 2016). At the same time, embedded linkages are formed with key industrial groups (usually productive ones) to devise policy. The bureaucracy functions based on codified rules (Weberian model) to enforce rules and ensure a friendly business environment while enabling firms to benefit from the state resources that enable them to attain developmental trajectory.

However, variations of institutions may not resemble the ideal type of bureaucracy in a developmental state. Historical roots can have implications on the institutional design thus affecting how bureaucracy functions. In the case of Malaysia, based on the qualitative data analysis most respondents agreed that the bureaucracy has a considerable role in industrial policy planning and implementation, though their influence on automotive policy is somehow limited. This is due to the institutional constraints given based on the wider political influences and consideration for 'selected' business groups (usually Bumiputra groups). The bureaucracy is insulated by political institutions, but industrial policy is guided by political elites along with industrial groups linked to the elites. Strong political interventions on the terms of policy mean bureaucrats need to meet the interest of the elite. Configuration is often against the overall economic objectives, however most public officials will still find ways to assert the political elite interest in policy configuration. Most public officials will work along the political elite ideas in relation to the NAP because freedom to advise on the matter is limited. Though at times the bureaucracy was tasked with improving strategy on the NAP, the decision to change the terms of policy remains in the hands of the political elite. Political interference compromises the bureaucratic autonomy in planning and implementing the NAP. The bureaucracies are guided by political interest so most policy is often subject to policy *layering*.

7.3.1 Politico - Bureaucratic Ties

Based on the interview data analysis, most bureaucrats agreed that they are tasked with devising industrial policy and making feasible plans. The principle agencies responsible for industrial policy planning such as the Economic Planning Units, Ministry of Industry and International Trade, and Malaysia Industrial Development Authority devise plans, negotiate policy terms with stakeholders, and conduct R&D to improve policy. Although top public officials may have freedom in policy planning, they are always constrained by strong political considerations. According to B3,

'…*the role of bureaucracy in policy planning and considering political interest is a tough one, it is not easy to deal with…our role is to come out with industrial policy based on the economic interest of the country…we engage in various consultations and studies to formulate policy…but I have to say, economic interest is always linked to political inspirations to stay in power…though I may disagree with this and offer my opinion against certain political interests…sometimes the Prime Minister will listen…but since our policy is guided by political inspirations I will usually just follow, after all he is our Prime Minister…'*

This statement shows that the bureaucrats will act upon the interest of the political elite although policy interest may not necessarily consider the overall economic welfare of the country. Interviews with most key senior officials agreed that they will work along with the political master's interests. Though they play an advisory role for the political elite, most top bureaucrats will accommodate political interest in industrial policy planning.

Bureaucratic power in contemporary Malaysian bureaucracy is derived from the political master (Beeson, 2000). Though the bureaucracies are not influenced by the electorate's decisions, the long-serving UMNO-led BN that dominates the political institutions can assert strong influences on the bureaucracy. This forms an unequal power relation between the state bureaucrats and the political elite, which constitutes an institutional constraint for bureaucrats to function independently. The qualitative data reveals that the limited role of the state bureaucracy started when Prime Minister Mahathir Mohammed introduced the heavy industrialisation programme to facilitate the growth of national car project. According to P1,

'…*the policy I introduced such as the Heavy Industrialisation Programme, Look East Policy, Malaysia Incorporation (Malaysia Inc.), privatisation and Vision 2020, are all about industrialising the country. To do so, of course we have to make our government administration effective enough to support a good business environment. So, we need to reform our bureaucracy so they are effective…'*

Most respondents reveal that since Mahathir, administrative reforms have changed the role of bureaucracy in economic policy making. The ideal role of bureaucracy in a developmentalist state approach is for the political elite to provide vision for industrial development, while most of the planning and implementation are done by the technocrats. However, while Mahathir attempted to make the bureaucracy effective to implement his bold plans, he has in fact intervened in most industrial policy making, particularly in relation to the automotive industries. As a consequence, policy-making and ideas come from the executive branch and reduce the role of bureaucrats, as Khalid and Abidin (2014) point out that technocrats in bureaucracy now 'take the backseat' in the policy-making process.

The administrative reforms (like *Malaysia Inc.,* which was followed by privatisation) in the Mahathir era aimed to make the state bureaucracy responsive to the needs of domestic private enterprise to hasten industrial development (Jomo and Wee, 2014). Commenting on this, A1 points out that,

'…*Mahathir is impatient with the civil servant in terms of the industrial development planning, so the administrative reforms were to make the bureaucracy prioritise the domestic private interest*…'

Prioritising domestic enterprises is usually linked to the political elite interest. The national car company is a prime example of this. This formed embedded linkages for the national car company and other Bumiputra vendors, giving them privileged access to the state resources. Having control of the bureaucracy is thus crucial to enable the political elite to influence macroeconomic policy.

As a consequence of the bureaucratic reforms, the state's institutions have linked to politically favoured industrial groups like Proton and Perodua. As Evan (1995) argues, state bureaucracy requires a certain degree of freedom to be 'connected' with productive groups in the society for economic transformation. Here, connection is the 'embedded linkage' between government and private enterprise to negotiate policy terms to achieve industrial development trajectory. If it is politically captured though, it will compromise the bureaucracy's autonomy to implement coherent industrial policy. In the case of Malaysia, it is unlikely for bureaucrats to act independently due to the executive dominance in the bureaucracy. Freedom to link with other productive groups in the society is constrained by political actors going along with racial considerations. Executive dominance has serious implications on industrial policy implementation. Interviews with A1 and A3 share the similar opinion that Mahathir's administrative reforms have made the bureaucracy subservient to the political elite. Administrative reforms give rise to politico-bureaucratic ties where the political elite has 'authoritative order' over the bureaucracy. Strong ties between politicians and top officials have become the 'institutional legacy'. Therefore the state bureaucracy's overriding goal is to serve the political master's interest.

The politico-bureaucratic ties have given the political elite capacity to impose its will onto the bureaucracy. Interviews with top officials suggest that they need to work along with the politician's ideas and interests. There is broad influence of political interference making their 'hands tight', especially in the configuration of the national automotive policy. The bureaucracy has limited freedom to formulate automotive policy. Although state agencies like EPU, MITI and MAI conduct studies to improve the NAP, to change aspects of the policy is difficult. Adjusting policy terms is subject to political interference and the need to consider the national car companies and local vendors' interests.

Institutional arrangements formed between politicians and the bureaucracy have allowed politicians to direct the bureaucracy in interpreting policy to secure the interests of the domestic enterprise in the automotive industry. Based on the interview data analysis, respondents have used the term 'policy tweaking' to describe the configuration of the national automotive policy. Policy tweaking is akin to '*layering*' (when new rules are introduced but do not displace the old rules) and '*conversion'* (when rules formally remain but are interpreted and enacted differently) of rules (Mohaney and Thelen, 2010). Even though the NAP aims to liberalise the industry, institutional arrangements between the political elite and bureaucracy enable them to 'tweak the policy' in favour of the national car company and vendors linked to its production chains. Special arrangements have taken place between local companies, state officials and politicians to discuss policy tweaking in order to protect the domestic automotive industry, even though this may go against the interest of top civil servants. According to B1, '*we have no choice but we need to figure out how to tweak policy to protect the national car company…the national car company is the so-called national interest because there are many vendors linked to the car company's ecosystem'.*

Analysis from the interview data reveals that the dense ties between politicians and state bureaucracy have shaped policy layering in the NAP, which is not in consonance with the pro-market reforms. As stated in the earlier section, the national car project is perceived as a source of national pride for the country. The local auto carmakers have played an important role to create jobs and forge linkages to move up the automotive value chain, and local vendors have heavily relied on Proton and Perodua to sustain their businesses. In this sense, despite there being pro-market reforms in the domestic automotive industry, the actual practice in the marketplace remains regulated by the government. Though Malaysia is committed to reducing tariffs under the WTO and AFTA obligations, the government introduced excise duties to protect the domestic automotive industry. According to B1,

'Malaysia's excise duty imposed on cars is one of the highest in the Southeast Asia region, ranging from 75% to 105% depending on engine capacity. This obviously leads to price discrimination to protect national carmakers.

Although government committed to the obligation of reducing tariffs, however excise duty is the right of the country to impose goods and services. Policy makers can impose higher excise duty for foreign cars. The reason for this is that excise duty is used to offset the significant reduction of tariff barriers which the government has to commit to for progressive liberalisation. The policy tweak gives price advantage to the local auto carmakers that can constitute a direct challenge to the homemade car.

Another example of policy layering with regards to the NAP is the localisation policy. Based on TRIMs, the agreement prohibits the use of performance investment measures such as the local content requirement, whereby firms need to source local firms. The localisation policy is considered one of the policies that limits a free business environment in a host economy, as a regulated business environment with the host government imposing measures to favour local firms defeats the principle of national treatment and free business (UNCTAD, 2006; Hoekman, 2005). Since local the content policy is restricted among WTO member governments, the Malaysian government has abolished the localisation policy since 2002. Based on the data findings, the localisation policy in Malaysia is associated with the vendor development programme and most of the vendors are Bumiputra companies. Given the politico-bureaucratic ties, policymakers seek ways to tweak policy to sustain local vendor businesses. One way to encourage car assemblers to source local components and kits is through excise duty reductions. According to B7,

'…we may have high excise duty for foreign cars but companies will get a tax reduction if they source the auto parts and kits from local vendors. Similarly, C9 notes that '*the government likes to tweak policy, they will find way to help the local vendors…one of the strategies they offer is giving us a discount on excise duty if non-national carmakers buy from the local vendor…*'

C10 reiterates that '*we buy local parts and kits, which makes our car prices more competitive in the market'*. This is part of the government strategy for coming up with new rules but with same intention: that is, to encourage more inflow for CBUs. It can promote further linkages with local vendors for technological upscaling and improving productions.

In general, this strategy does not really violate the WTO obligation under TRIMs (Segawa et al., 2014). Furthermore, the TRIMs agreement remains vague in interpretation (Tham, 2014), especially as the agreement continues allowing host governments to impose measures for foreign firms in the areas of human capital development and technological transfers. This creates policy space for most developing countries to interpret sourcing local auto parts and components to assist local firms in developing new products and skills upscaling. The data findings suggest that though linking excise duty reductions with localisation is one way to promote the auto industry which does not constitute a 'restrictive business environment', the extent to which the government is transparent in providing the incentives for local content remains low among other auto assemblers, because the government is unlikely to reduce excise duty significantly due to potential threats to local carmakers. For this reason, the provision of incentives is unlikely to favour foreign automakers much. For instance, Toyota, the largest auto assembler (after Proton and Perodua) uses only 45-50 per cent local content (Segawa et al., 2014). As C9 mentions, selective incentives in excise duty reductions have discouraged foreign companies in sourcing local auto components. The findings also reveal that to a certain extent most firms are sceptical about the quality of the auto kits supplied by local vendors.

Policy layering in the NAP intends to facilitate the local car manufacturers. While sourcing local parts and components can reduce excise duties, the actual intention is to enable the national car producers to obtain further excise duty reductions. Based on the findings, every car sold within Malaysia's borders is taxed the same, regardless of make, model, or origin. This is one of the AFTA rules that prevents member nations from discriminating against other foreign companies. However, Proton and Perodua's parts and components are supplied by local vendors since the excise duty rebates are based on the amount of local contents, so with the 90 per cent local content makes the national car producers pay little excise duty. By linking the excise duty reduction scheme with the level of local contents, the national car producers receive a cost advantage in the automotive market. As stated in chapter 5, even though the overall market share of the local carmakers has shrunk over the years following 2006's liberalisation, they remain dominant in the domestic automotive market due to less excise duty imposed on both national carmakers.

The interview data showed that most policy elites suggest that linking the local content requirement with excise duty is done to increase economies of scale for the national car company. They suggest that the national car should increase their market share in the local market. According to B7,

'*…we have a duty to facilitate our homegrown car and obligations to help the local vendors so that they can achieve economies of scale…this is also a national mission to help the Bumiputra vendors in another way…'*.

The study shows that the existing funds as stated in the NAP are to facilitate the growth of the domestic automotive industry, including the Industrial Adjustment Fund, Automotive Industrial Fund, and Industrial Linkages Fund. These are offered by the government to support the industry, especially vendors linked to the supply chain for national car producers. Most respondents reveal that the policy tweaking is also an arrangement between the government and politicians to come out with *de facto* protective measures after liberalisation. As C5 states, the national car project ought to have indirect incentives because as national car producers, the mission is not just purely economic growth but also to encourage the growth of Bumiputra vendors.

The politico-bureaucratic ties enable politicians to direct bureaucrats to implement policy that favours the interest of domestic enterprise. The interview data confirms that most aspects of the NAP are designed to facilitate the national car company to have a greater market share. The Prime Minister Najib states

'*A manufacturer that is a source of national pride was facing a very difficult situation…the government needs to step in to protect Malaysian jobs, to protect Malaysian families who rely on Proton and to protect the company's business partners' income and livelihoods…the government will never fail to support Malaysian workers and suppliers, we will always fight to ensure that no one is left behind* (News Strait Times, 2016).

Most respondents in the bureaucracy are obligated by the Prime Minister's interest to facilitate the national car company, as B2 states that, '*as a policy maker imagine the national car is your child, you don't want them to do die if they need help.'*

Politico-bureaucratic ties also facilitate special preferential access to state funds. Based on the interview data analysis, the government has channelled a substantial amount of funds for Proton to assist in the areas of R&D. According to P1, '*there is a cost for everything we do and we have to deal with it'*. This is due to the fact that the national car company is unable to achieve greater economies of scale, which limits R&D activities. Since the company resembles national and Bumiputra interests, the government needs to provide a fund for R&D activities to increase productivity. The politico-bureaucratic ties have made it easier to mobilise substantial funds to support the growth of the national company. The findings also reveal that special arrangements have been made between the state oil company, Petronas, and Proton, to provide RM30 million to the car company though the board of Petronas does not agree to such funding.

In a developmental state, the key to improving industrial policy is constant negotiation between the bureaucracy and business groups. The government pilot agency is insulated and has less political intervention, which enables the agency to devise more effective industrial upgrading plans with specific groups. However, in the context of Malaysia, politico-bureaucratic ties limit the capacity of the bureaucracy to negotiate with other business groups. Most respondents suggest that strategic planning or changes in the NAP require permission from the 'advisor of Proton'. B1 states that the bureaucrats have limited say when it comes to the national car project, particularly in searching for strategic partnerships and R&D. According to B6,

'*…we all know that liberalisation is the way forward for the automotive industry, we all know that the national car company that is Proton needs strategic partners to revamp the company, access R&D and expand the export marke, but we can't do anything because it is highly political…'*

Most respondents agreed that they have to work along with the interests of the political elite. Political interference gives the senior officials limited freedom to configure strategy to improve automotive policy planning.

7.4 Conclusion

The above analysis presents the political economy and politics of Malaysia's national automotive policy. The role of institutions, along with a developmentalist state approach, accentuates the strategic role of the state elites (politicians, bureaucrats) and industrial groups (linked to state elites) in configuring national automotive policy. Institutional arrangements taking place by this tripartite arrangement have implications on policy planning and implementation. Despite the fact that the overarching policy intended to liberalise the domestic automotive industry, the dynamic of the politics behind institutional arrangements for the NAP limits pro-market reforms due to vested interest to protect the industry.

Given the longevity of the ruling coalition (UMNO-led BN), political institutions have the capacity to direct the automotive policy in Malaysia's policy-making institutions. Ideas and interest surrounding the NAP are largely manufactured by the political elite. The historical specificity that structures the power relations centred around the executive branch enables the Prime Minister to come out with a specific interest in industrial policy. The idea for the national car project is evidence that the Prime Minister has asserted his interest as part of the heavy industrialisation programme. The existing institutional capacity enables the Prime Minister to pursue his interest as part of industrial development due to the uneven power relations of other political actors. The institutional design structures the power concentration on political elites in UMNO (who dominate the political institutions). The executive branch can therefore can fend off other demands coming from other economic actors, as Campbell (1997) argues that limited interaction in political institutions due to uneven power relations hinders policy changes.

The national car project under the heavy industrialisation programme shows that the country adopted a developmentalist state approach, where it envisioned transforming the industrial structures to a capital-intensive based economy. While the country holds this economic objective, it is also embedded with the political consideration of Bumiputra interest. Navigating the racial policy and economic development have been central to UMNO's political legitimacy. Bumiputra interest has been infused into the policy-making institutions since the NEP was introduced. Since institutions structure policy options, ethnic consideration has been institutionalised in configuring policy, and it influences the cognitive dimension of political elites in 'packaging' industrial policy. The national car project is interpreted as industrial nationalism with strong emphasis on the development of Bumiputra groups to lead the country's industrial development. It is part of the redistributive programme for the indigenous groups as designated under the NEP. The 'interpretative frame' of the national car project, coloured with racial undertones, became acceptable policy discourse for the ruling elite to support the local car company despite it being uncompetitive.

As a developmental state, the role of institutions in Malaysia facilitates a reciprocal relationship between the government and industrial groups. Like the Northeast Asian developmental state, the government is linked to existing productive groups in the society. However, in the case of Malaysia where there is an absence of industrial groups, the political elite forms such groups to pursue industrial development. Such industrial groups are highly dependent on state resources, even after being privatised, particularly Proton. The collaboration between the government and industrial groups to facilitate heavy industrial development has strengthened patron-client ties over time. The inability of the national car project to arrive at a higher technological frontier while operating on an uneconomical scale accentuates informal linkages to obtain government support. For such reasons, informal rules also become powerful interactions in policy-making institutions among actors to obtain preferential access to state rents. The highly criticised AP system designed for Bumiputra entrepreneurs is also evidence of the patron-client network in action. Despite the fact that the system distorts the level of playing field in the automotive market, political actors have delayed the removal of the system. Such resistance to change is due to the close-knit ties between the AP holders and politicians. The ethnic imperative is also used as part of the discourse to retain the AP system.

Since informal institutions are widely accepted norms in the policy-making institutions of Malaysia, they become a critical part of maintaining and preventing changes in formal rules. The patron-client ties lead to unusual policy arrangements to protect the interest of domestic automotive enterprises by determining prices for foreign cars through informal arrangements and by being ambiguous in the provision of incentives under the NAP. Such unclear information regarding customised incentives is a way to protect domestic automotive industry.

The role of institutions facilitates the politico-bureaucratic ties. While the bureaucracy needs to be insulated from other private demands by political institutions to implement coherent policy, in Malaysia's institutional context the bureaucracies are insulated by political institutions but policy formation is guided by political interest. The bureaucrats have limited freedom to devise strategy in the NAP. The executive dominance in political institutions has the ability to control the state's agency. This makes the bureaucracy subservient to political masters' interests, and as such the political elite can impose their will in the NAP planning and implementation. Furthermore, the bureaucracy is connected to unproductive groups like Proton. Institutional arrangements are formed to further support the groups and the bureaucracy is unable to replace the support due to political interference. This departs from the conventional developmentalist state approach in Northeast Asia whereby the bureaucrats have sufficient freedom to deliberate with specific industrial groups. For this reason, policy layering becomes inevitable against the backdrop of pro-market reforms. The bureaucrats are obliged to interpret policy in favour of domestic interest, thus limiting changes based on the liberalisation initiative under the NAP.

In short, the politics behind the NAP in Malaysia reveal that the institutional arrangements made by the political elite, bureaucracy and industrial groups have powerful implications on Malaysia's automotive industry. The historical specificity, power relations, and normative dimension of Malaysia's institutional context affects the interactions between the principle actors in policy-making institutions. The triangular arrangement between them can rig the allocation of resources and adjust the terms of policy that potentially undermine the overall welfare of the economy. Despite the country having adopted a developmentalist state approach, due to a different institutional context the country has produced different industrial policy and therefore outcomes different than those in Northeast Asia.

Chapter 8

Conclusion

8.0 Discussion of Key Findings and Implications

This research aims to explore the political economy and politics of industrial policy-making institutions in Malaysia, particularly in its national automotive policy. To uncover the politics of the national automotive policy, this study seeks to explore the institutional arrangements that evolve around the national automotive policy. Given that institutional structures underpin the strategic role of the state elite (politicians and bureaucrats) and 'selected' business groups in policy-making institutions, this study also aims to explore how these economic actors mobilise, coordinate, and prioritise resources and economic preferences in the policy-making institutions. This study reveals the politics behind Malaysia's policy-making institutions, which have not been widely explored particularly in regard to the national automotive policy.

The empirical investigation from this research presents that the triangular arrangement between the political elite, bureaucrats and selected enterprises (in this case the national carmaker and its vendors) represents the crucial economic actors in policy formulation and implementations. However, power relations are centred around the Prime Minister's Office. The political elite have a paternalistic role in policy decisions, which has implications on policy direction, especially regarding the national automotive policy. The political agenda and preferences are thus manufactured by the ruling elite due to the concentration of power around the political executive. This is inevitable due to the longevity of UMNO-led Barisan Nasional dominating the political institutions. This arrangement has also developed strong politico-bureaucratic ties that enable the ruling elite to impose their will into the bureaucracy. Strong political influences limit the freedom of the bureaucracy, which is at the heart of policy implementation. As empirical findings suggest, the main government agencies such as MITI, EPU and MIDA have limited freedom to devise policy. In most policy-making processes the bureaucrats' 'hands are tied', and though they are supposed to play advisory role, the priority of the policy is likely to advance or maintain the interests of the political elite (Ansori, 2013; Searle, 1999; Loh, 2015).

Given the strong politico-bureaucratic ties in the policy-making process, it is also worked to maintain the interest of the selected business enterprises who have close connections with the political elite. These selected business groups, including the national carmaker and Bumiputra entrepreneurs who are involved in the automotive sectors, are created by the political elite. The creation of the Bumiputra industrial class is meant to enable the group to lead the industrial development of the country. Their development in the automotive sectors has been heavily dependent on government resources.

Assessment of the NAP shows that, though the intention of the policy is to liberalise the automotive industry, this is not done straightforwardly. Though the government is committed to progressive liberalisation such as the removal of the local content requirement, reducing tariffs and relaxing other non-tariff barriers (issuance of licenses), institutional arrangements take place to protect the interests of the national carmaker and its vendors, who are mainly Bumiputra entrepreneurs. Given that the government has substantial interests in the domestic automotive industry to protect the interest of selected business groups, protective measures are retained despite not always being consistent with the liberalisation initiative. As discussed in Chapters 5 and 6, some protective measures are retained to ensure foreign auto companies do not constitute a threat to the national carmaker and to maintain its vendors in the automotive production network.

An important aspect of the automotive industry is that the ruling elite has framed the industry as nationalist economic project which includes the localisation policy (under the vendor programme), AP system and the national car project. Most programmes and policy introduced around automotive sectors are mainly to pursue domestic economic transformation, and more crucially, the development of Bumiputra business groups. In this sense, elite policy actors resist or seek ways to protect any pro-market reforms that undermine the interests of Bumiputra business groups. However, liberalising the automotive industry is inevitable because the government has to maintain a market-friendly environment for foreign and other auto companies in the domestic automotive industry, which is typical in the developmentalist state approach in Southeast Asia (Low, 2004). The extent to which the government will develop a 'market friendly' automotive policy remains sceptical. As Whitely (2003) points out, the institutions of a developmentalist state enable policy actors to design market entry in a way to protect domestic interests. The empirical findings suggest that the existing institutional structures in Malaysia support reciprocal relations between state actors (political elites and bureaucrats) and selected business groups. Interaction between the theses actors enables them to adjust policy terms in favour of the domestic enterprises. Institutional arrangements taking place by these actors enable them to come out with 'unusual policy arrangements' to protect the interest of the national carmaker and Bumiputra vendors. This involves policy tweaking, which is linked to *layering* and *conversion*[51] as part of 'mobilisation of bias' by policy elites (Schattshneider, 1957; Mohaney and Thelen, 2010). This includes replacing tariffs with excise duties, setting prices for imported vehicles, linking customised incentives with local contents and allowing special consideration for Bumiputra vendors as presented in Chapter 7.

The existing institutional structures facilitate a reciprocal relationship between the government and 'selected' industrial groups that is crucial to support the growth of the automotive industry in Malaysia. Without a reciprocal relationship the 'selected' domestic industrial groups (particularly the Bumiputra groups) would be unable to compete in the marketplace. However, it has also institutionalised the patron-client network (informal institutions) (Gomez, 2012), which has formed a routine or culture that influences the behaviour of economic actors (Dimaggio, 1998; Meyer, 2010). Furthermore, the racial consideration in economic development has accentuated the patronage system, particularly between Bumiputra groups and the political elite (Gomez, 2009; Tan, 2014; Jomo, 2014). The informal linkages can be a powerful mode of exchange, negotiation and securing preferences (Helmke and Levitsky, 2004; O'Donnell, 1996). As Scott (2008) and Dimaggio and Powell (1991) point out, informal institutions are norms or setting the standard operating procedures that reflect how 'people do what they do' or 'how things are done', including policy tweaking among political and Bumiputra business actors.

The empirical assessment suggests that some policy terms in the NAP are difficult to remove, such as the AP system, though this import quota can distort the domestic automotive market. Given the lack of transparency in policy making, this encourages informal linkages in policy negotiations. For instance, Proton engaged in various informal negotiations to obtain preferential access to substantial state resources with a lack of public knowledge. The informal network also seems to be a way of obtaining funds designated under the NAP such as the Industrial Adjustment Fund, Automotive Development Fund, and Industrial Development Linkages. Since these funds are to support local vendors in upgrading machinery, building linkages, and creating technological advancements in auto kits production, such funds can be disguised as subsidies. Based on the review of the literature and empirical assessment, Bumiputra vendors who are linked to the national carmaker production chain are likely to obtain such financial support. It can be argued that close linkages with state officials are an important part of the strategy to secure such funds.

[51] Layering is the creation of new rules together with old ones but change occurs not through the displacement of old rules, rather through the addition of new ones on top of old ones. Conversion is when rules remain formally the same but are interpreted and enacted differently (Mohaney and Thelen, 2010, p.17).

The formation of the national car project is an important aspect of Malaysia's automotive industry. The project holds important prospects for industrialising the country, and on the economic front its purpose was to rationalise the automotive industry through the localisation programme as part of building linkages with foreign automakers (during the early development of the automotive industry). The project also enabled the Bumiputra group to lead the heavy industrialisation while simultaneously nurturing the growth of Bumiputra vendors in the automotive production chain. This was done as part of the redistributive programme for indigenous groups as designated under the NEP (Felker, 2015; Jomo et al., 1999). As institutions structure the interpretive frame of policy ideas and preferences (Schmidt, 2008; Campbell, 1998), the national car project was 'packaged' with industrial nationalism along with racial considerations. Under such policy, this 'package' was deemed an acceptable project to spur heavy industrial development.

The national car project is also an attempt to pursue an 'independent mode' in car production which is heavily backed by government. Industrial policy on the automotive sector is devised to move up the automotive production from assembling CKDs with increasing locally-made content to the full-scale manufacture of motor vehicles. Given that Malaysia has a weak industrial base for heavy industry, without the ruling elite orchestrating the automotive policy it is impossible for the country to arrive as a full-scale automobile producer. Becoming a full-scale producer of automobiles delineates the strength of the institutional capacity of Malaysia in configuring industrial policy and strategy (Doner, 1992; Abbott, 2003), which is different from other Southeast Asia countries that engage in automotive productions.

Given that there is a weak link between the political institutions and societal groups in Malaysia, compounded by uneven power relations in the policy-making institutions, the domestic institutional design enables the political elite to fend off other economic actor interests who oppose the projects. The executive dominance in the policy-making process enables the elite to transfer resources and adjust policy in favour of the growth of the national car projects, despite there being no comparative advantage. The institutional context that structured the power relations centred around the executive branch enables the political elite to suppress other sectional groups' interests. This features the institutional capacity in the developmentalist state approach, where the ruling elite are able to impose their will in the developmental agenda (Wade, 1990). This can be seen in the considerable amount of funds allocated for physical infrastructures, production plants, technological investments and research and development to support the domestic automotive sector.

Empirical assessment of the national automotive policy shows that the policy is constrained by the interest of the national car projects, especially Proton. The NAP, it can be argued, is a product of the government and national carmaker alliance (Govindaraju, 2010). The presence of the national car project has limited pro-market reforms and has made policy inconsistent (Jomo, 2008). Under the rubric of 'national interest', various policy arrangements (both formal and informal) have taken place to facilitate and protect the interest of the national carmaker. As stated earlier (see Chapters 6 and 7), institutional arrangements between Proton and the ruling elite had taken place to maintain preferential access to state resources. Coordination between elite policy actors also attempted to ensure that Proton is able to compete in the marketplace with some advantageous position over non-national cars. It can be argued that the national car project is able to compete in the market based on government reciprocal relationships accentuated by a deeply embedded patron-client network. This is inevitable because the national car project was created by political elite and the growth of Proton has been highly dependent on economic rents since the outset of the heavy industrialisation programme. The dependence on economic rents is part of the policy legacies (associated with path dependence), as Pierson (1994), Thelen (1999) and Beissinger and Young (2002) describe that once certain norms or routines are institutionalised, they become an 'intergenerational' transfer in the policy-making process. Furthermore, the creation of Proton is associated with the development of the Bumiputra industrialist class that is dependent on the government, so it is difficult to be removed in the institutional setting. This is further reinforced by the UMNO domination of the policy-making institutions.

The role of institutions in Malaysia has limited the growth of Proton. Empirical analysis suggests that there is excessive political interference which become institutional constraints, hence compromised the growth of Proton. The national car company has limited freedom in most management decisions. The political elite has strong influence on the direction of the company and its technological upgrading, as presented in chapter 6. Though political influence is crucial for the growth of Proton, too much interference and emphasis on ethnic requirements have made the national car company less competitive. This makes the company reliant on the domestic automotive market and further accentuates the role of elite policy actors in maintaining the company's interest in the market.

Another problem with Proton is its ability to form partnerships with other foreign auto carmakers. This is a necessity because the national carmaker needs market expansion to address its excessive production capacity, marketing capability and access to technology. However, political factors and nationalism have become institutional constraints for national carmakers forming partnerships. The empirical analysis shows that the national carmaker represents national pride and major development of the Bumiputra industrialist class. Partnership agreements usually may entail ceding management control of the national car company. This has been a challenging task for Proton, because in ceding control the new management is likely to undermine the Bumiputra interest in Proton and its vendors. This has undermined plausible strategic partnership agreements with most major foreign automobile companies. While forming partnerships would enable the company to improve efficiency, the role of institutional made political considerations precedes economic efficiency.

In summary, the role of institutions in Malaysia has facilitated the growth of the automotive sector, as the existing institutional capacity has enabled the elite to shift resources, adjust policy and coordinate policy actors to develop the domestic automotive industry and form the national car project. Political elite managed to shift the comparative advantage of the state which was previously limited. More crucially, the Bumiputra industrialist class was created through the national car project. The strategic role of the state elite (politicians and bureaucracy) and the national carmaker enabled them to respond to trade liberalisation (through institutional arrangements) that could potentially affect their interest in automotive sectors. The tripartite arrangements enable the national carmaker to sustain in the market competitions while preserving the Bumiputra interest. Though the role of institutions facilitates the growth of the domestic automotive industry, it has also constrained the growth of the industry and the national car company. Elite policy makers are unable to be flexible in policy changes in the NAP due to vested interest. Opening the automotive market can improve efficiency but competing on a level playing field can undermine the national car company and the Bumiputra industrialist class interest. The patronage system and political interference has led to rigidity in the NAP. A strong political grip in configuring the NAP has compromised coherent policy implementation.

8.1 Theoretical Implications

Institutions (rules of the game) are not homogenous across the country. They have roots in historical, political and normative factors (Haggard, 1990; Hall and Taylor, 1996; Whitley, 1999; Scott, 2001). Institutions are a necessary condition to devise industrial policy (Chang, 2003), but different institutional contexts engender different developmentalist state approaches. As such, they produce different developmental strategies and industrial outcomes. In the case of Malaysia's institutional context, it is broadly influenced by historical events, political factors, power relations and ethno-nationalism. Therefore, the policy-making institutions are different from the ideal developmentalist state approaches like those in Northeast Asia. A typical developmentalist state approach underpins the role of political executives, bureaucracy and selected domestic enterprises to pursue economic transformation projects (Moon and Prasaad, 1994; Johnson, 1999; Onis, 1991; Weiss, 1999; Evan, 1994). The ruling elite provide visions and bureaucrats are tasked with implementing industrial policy. The bureaucracy is central in planning, allocating resources and implementing policy (Johnson, 1989). The political institutions insulate the bureaucracy from private interferences or organised groups. The bureaucracy has free autonomy to deliberate with the productive groups in the society. This creates a reciprocal relationship between the bureaucracy and productive private groups to implement industrial policy.

In Malaysia's institutional context, though it adopted a developmentalist state approach it has departed from such ideal approaches. Instead, the role the institutions have on structuring the power relations is concentrated around political executive, which has led to strong politico-bureaucratic ties. These ties have given the political elite considerable influence in policy-making institutions, including in the role of bureaucracy. Historical events (as path dependence) and domestic political factors have brought about uneven power relations in industrial policy-making, mainly as a result of the longevity of UMNO-led BN in dominating the political institutions and the emphasis on the Bumiputra groups' interest since the formation of the NEP (Mauzy and Milne, 1991; Nelson, 2012; Chin, 2015). The political elite has the capacity to impose its will in the bureaucracy, which compromises the role of bureaucracy in industrial policy planning and implementation. It can be argued that the bureaucracy is politically captured and that reality undermines the coherent implementation of industrial policy. In this case, the bureaucrats are compelled to work along with unproductive industrial groups. These groups are the rentier class that depends on state resources. The groups are politically created and elite policy actors are likely to preserve their interests because they represent the Bumiputra industrialist class who are linked to the political elite.

The institutional design has implications on the developmental strategy adopted by the elite policymakers. As most institutionalist scholars have argued, country-specific institutions can produce different developmental state approaches, as Malaysia's developmental strategy is different from the Northeast Asian countries, particularly in the aspect of developmental legitimacy (Low, 2004; Abbott, 2004; 2003). Northeast Asia consists of a homogeneous society and hence there is less 'ethnic imperative' in its pursuit of developmental goals. The configuration of industrial policy is unlikely linked to specific ethnic demands and has limited political considerations. Rather, industrial policy is mainly formulated to achieve economic transformation, with the elite policy actors and domestic enterprises committed to modernising the countries through industrialisation projects (Chang, 2003; Jomo, 2004). In the context of Malaysia, though the country is a heterogenous society, the historical context has influenced the institutions to focus on ethno-economic development (Tan, 2009). This is stark contrast to the ideal developmentalist state approach. Ethnic considerations and economic development tend to intertwine, because to maintain power of the political elites is to ensure ethnic interests linked to economic development projects. The development of the Bumiputra class is associated with the interests of the political elites, and the ethno-economic development has been used as part of pursuing nationalist economic projects. In sum, ethno-economic development is part of the political legitimacy of the ruling elites (Gomez and Premdas, 2016; Gomez and Jomo, 1997). So, when the role of institutions prioritises political elites and Bumiputra class interests, political legitimacy precedes economic consideration in configuring industrial policy.

Institutions affect the interpretation of ideas and configuration of policy preferences (Campbell,1997a; 1998). Since the development of the Bumiputra has become an important part of the UMNO-led BN's developmental legitimacy and ideology in configuring industrial policy, the increase of participation of Bumiputra in economic activities is part of the political legitimacy for the party (Gomez and Jomo, 1997). The importance of maintaining the interest of the rentier class along with 'ethnic imperatives' infused into the institutions (Yusuf, 2012; Gomez and Jomo, 1997); hence, the institutions have affected the policy-making institutions in configuring industrial policy. As Ritchie (2004) argues, the political elite drive illiberal intervention in the economy by favouring politically well-connected business groups. They are able to do so because the institutional arrangements can facilitate such action.

Institutions are linked to path dependence that potentially constrains or facilitates policy making (Thelen, 1999). The Bumiputra agenda has created path dependence since the formation of the NEP. The Bumiputra agenda becomes policy legacies in shaping policy preferences. The political elite have used the Bumiputra agenda as an interpretive frame to 'package' industrial policy to mobilise resources and maintain economic rents for Bumiputra groups to promote the automotive industry. The Bumiputra agenda is difficult to remove as it is deeply embedded in the institutions.

The role of institutions in underpinning reciprocal relationships in a developmentalist state approach is crucial for the selected private enterprises to be competitive (Amsden, 2001; Abbott, 2004). Institutional arrangements through private-government consultation are a deliberation process to devise feasible industrial policy. In the case of South Korea, for instance, Hyundai (*Chaebols*[52]) depends on close connections with the government to negotiate and deliberate plans for technological catching-up and mobilisation of resources to ensure that *Chaebols* is an exportable, competitive brand. However, in the case of Malaysia, the role of institutions has limited the bureaucrats and Proton in configuring policy. Instead, policy direction, determining resources allocation, technological advancement and the company strategy are likely to be 'hijacked' by political elites.

Leveraging from the historical and sociological institutionalism, economic actors are not seen as utility maximisers (Braath, 1994, Steinmo, 2008). Instead, policy actors respond to the domestic institutional demand that is based on the specific institutional context in configuring policy preferences. Here the policy actor would act out 'what is appropriate' based on the institutional context (Hall and Taylor, 1996; Scott, 2008), and economic efficiency may not necessarily be a priority for actors when the institutions (rules of the game) underpin political considerations. Though the NAP may appear as part of pro-market reforms, various institutional arrangements are formed to retain the domestic enterprise's interest at the expense of market efficiency.

In short, the role of institutions is endogenous to domestic factors (history, political process, power relations and embedded conventions), affecting how political and economic actors are organised in policy-making institutions. While elite policy actors adopt a developmentalist state approach, how industrial policy is devised is largely influenced by the institutions in which the actors are embedded in. Malaysia's institutional setting enables a triangular arrangement (political elite, bureaucrats and selected enterprises) to pursue industrial development. Though institutional arrangements of these three actors have enabled the growth of the domestic auto industry over the years, institutional arrangements are subject to the broader influence of institutional context and political economy demand. Priority in policy-making institutions has been biased towards political and domestic enterprise interest coupled with ethno-nationalism, which has strongly influenced industrial policy configuration. A developmental state approach enables a country to pursue an economic transformation project through industrial policy, but the ability to make such a transformation is limited if the role of institutions subordinates the overall economic objectives.

[52] This term refers to large industrial conglomerate in South Korea who has close ties with government.

8.2 Contribution of this study

This study contributes new knowledge about policy-making institutions, specifically in relation to Malaysia's national automotive policy. This policy, which forms part of the heavy industrialisation project, is inherently political. This study has shown that politics cannot be separated from the industrial policy process, which in this case is the national automotive policy. This research has provided new insights on how the institutional capacity is able to form, nurture and maintain the growth of the domestic automotive sector. Elite policy actors can shift resources and coordinate policy to defend the interests of the national carmaker and domestic vendors in such a way that enables them to grow in the marketplace. However, further development is constrained by the institutional context and domestic political economy, such as political interest and the Bumiputra rentier class.

This research provides insights into how actors perceive interest, interpret ideas and coordinate policy arrangements, as there is scant attention to it in the literature on political economy and politics of industrial policy process, specifically in relation to Malaysia's national automotive policy. The empirical evidence has shown that the 'triangular arrangement' of the political elite, heads of bureaucracy and Bumiputra enterprises can shape, facilitate and constrain policy configurations. The interactions between these actors can adjust policy terms to defend the domestic automotive interest, despite liberalisation pressures. The empirical analysis reveals that institutional arrangements in the national automotive policy remain a limited pro-market reform. Despite the fact that the NAP appears to liberalise the automotive industry, various policy arrangements and interpretations of policy in the NAP are inconsistent in improving overall automotive market efficiency. Instead, government vested interests become the primary consideration.

UMNO hegemony has implications in the policy-making institutions in Malaysia, particularly regarding power relations that have been centred around the executive branch. For this reason, ideas, preferences, and direction of policy is inevitably derived from the Prime Minister's Office. The principle constraint in the NAP is the ethnic development requirement often 'package' under industrial nationalism. This shows that political consideration precedes economic efficiency due to the Bumiputra agenda, and UMNO has used the ethnic development as part of its political legitimacy. Policy discourse leverages on ethno-development to define and defend policy agenda. Evidence shows that the Bumiputra agenda has shaped policy actors' consideration and has compromised policy changes. Patronage has become part of the informal interaction and coordination of policy. This is due to the UMNO political culture, which also translated into policy-making institutions. This may be an advantage for the national carmaker and Bumiputra business classes who have close connections with political elite, because they are able to maintain their interest. However, it has compromised coherent NAP implementations at the expense of market efficiency.

This study also utilises theories of neo-institutionalism, institutional arrangement and the developmental state approach. This research has integrated these theoretical themes to make sense and explore the politics of Malaysia's policy-making institutions. This works to extend knowledge of assessing and exploring politics of industrial policy formations. The theoretical construction has enabled the explanation of why different institutions produce different developmentalist state approaches. This challenges the neo-classical paradigm, which tends to neglect variations in institutional design (Haggard, 2004; Doner et al., 2005; Chang, 2003; Whitely, 2003). It is important to note that institutions are endogenous to specific contexts. While a developmentalist state approach is associated with developing countries in pursuit of industrialisation, the specific institutional context can influence the way actors adopt the developmentalist state approach. The developmental state approach posits that the state consists of a set of institutions that structure interaction between actors. Since institutions structure the organisation of political and economic actors' interactions, therefore the institutional context can affect industrial policy formulation and direction (Onis, 1991; Kim, 2009; Chang, 1999, 2003; Haggard, 1990; Tan, 2009).

This research has also shown how historical and sociological institutionalism analyses policy-making institutions. Combining both paradigms, this study has highlighted how history, political factors, power relations, norms and embedded conventions have shaped and constrained elite policy actors' interactions. Policy-making institutions could not ignore historical events that have structured power relations between actors. This also includes how history has 'infused' ethnic development agendas in the domestic institutions. Political factors such as UMNO's longevity have a dominant role in institutional arrangements, which constitute 'how things are done' in policy decisions. The use of informal institutions (patronage) as a norm also influences the policy process. The theory of institutionalism has explained implications of the policy-making process existing between the tripartite arrangement. Utilising this theory also shows policy actors are not utility maximisers, but rather are actors responding to the domestic institutional demands (Dimaggio and Powell, 1991). It is important to note here that while institutionalism attempts to explain that a 'critical juncture' or shock (liberalisation) can lead to changes, this research shows actors as 'utility satificers'. Though elite policy actors may be seen as responding to change (Steinmo, 2008), their interpretation of policy remains steady to protect the economic actors' interest. This is linked to the path dependence that shapes and constrains policy actors' behaviour and actions (Thelen, 1999).

While incorporating the developmentalist state approach (which underpins the political elite, bureaucracy and selected enterprise in pursuit of economic transformation), the role of institutions, which has its roots in domestic factors, explains why a different developmentalist state approach is adopted (Chang, 2003). This research has shown the role of institutions in Malaysia incorporating an ethnic development agenda, which departs from the typical developmentalist state approach as seen in Northeast Asia. Reciprocal relationships are connected to the rent-seeking Bumiputra industrialist class. Ongoing support through government rent is difficult to remove due to the patronage culture embedded in the institutions. The bureaucracy is easily captured due to the institutional capacity of the political elite (connected to the Prime Minister's Office). In an ideal developmentalist state approach, the bureaucracy is insulated (with less political intervention) and reciprocal relationships are based on market discipline—the recipient of economic rents is assessed through export performance, and in short the aim is to improve economic efficiency. However, in Malaysia's context, such discipline has little enforcement as the evidence shows that Proton's lack of export competitiveness continues to receive preferential access to state financial resources and other supports. This is due to the institutional capacity that can ignore economic efficiency while being unconstrained by other societal forces due to the uneven playing field environment in policy-making institutions.

This research also utilises a qualitative method to obtain information through elite interviews. Such method provides deeper insights into the politics of policy-making process in Malaysia. The study sought the views of key policy actors in Malaysia through semi-structured interviews, as this allows researcher to understand, explore and interpret the phenomenon better. This research does not merely focus on the outcomes of the policy, but rather on understanding the motivation behind elite policy actors based on their beliefs and cognitive viewpoints.

8.3 Concluding Remarks

This study shows the politics behind policy-making institutions in Malaysia. The empirical analysis presented shows institutional arrangements made by actors and how the dynamics of politics can influence the policy-making process in the automotive industry in Malaysia's institutional setting. Institutions matter, but the institutional context influenced by history, power relations, political factors and embedded conventions is also crucial to understand the complex relationships and interactions among policy actors. This has implications in policy-making institutions, which in turn affects their developmental strategy as discussed in this research.

The major concern of industrial development in Malaysia (in this case in regard to the national automotive industry) does not lie in the policy, but rather in the country-specific institutions and excessive response to domestic political economy demand. To balance between the industrial accumulation and nationalist interest is difficult, however there is a need to relax the ethno-nationalist stance, reduce rent-seekers' interest (especially the unproductive groups) and reassess industrial development with economic rationale. The growth of Thailand, Indonesia and China in the automotive production network will continue to pressure Malaysia's automotive sectors. Protecting 'national interest' at the expense of public funds for almost four decades, there is a need to re-examine the interest of 'a national champion' with market discipline. Less emphasis on ethno-nationalism is critical for the automotive sector to grow. It is not worth maintaining 'national interest' if it is unable to be competitive.

Given the existing policy-making institutions, the future challenge for Malaysia's industrial development will be to graduate into a higher technological frontier. This will be difficult, as Malaysia's industrialisation progress can be 'stuck in the middle', or what Henderson and Phillips (2006) echoed as the 'stalling of Malaysia's industrialisation project'. This means that the country will (or has begun to) shift focus to service sectors (for example finance) as a new source of growth. Focusing on the service sector can eventually accelerate 'a premature deindustrialisation process', where the country has failed to progress in manufacturing sectors (or falls in value-added manufacturing productivity). While focusing on service sectors is important to generate country revenue, it should not be the handmaiden of capital accumulation. The investment in value-added manufacturing remains crucial to make progressive and sustainable economic growth. Industrial development is the source of technological advancement. Malaysia has invested substantially in industrial development and the country has the necessary resources to grow, provided that it maintains focus and improve its institutions.

There is a need to further research the role of the institutions and the growth of the national car project, particularly the technological upgrading. While this research was conducted, new development has also occurred in Proton. The long overdue search for partnership for Proton now has been sealed with Geely Zhejiang, which also owns Volvo. It would be interesting to research the technological transfer between the Chinese company and Proton. This is crucial for Proton to upgrade existing technology in order to improve economies of scale and access a wider export market. Changes in the NAP are expected as well after this partnership agreement, which would be interesting to assess, including changes in future policy terms and in the role of institutions in this area.

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Appendices

Appendix 1

INTERVIEWEES: POLITICIANS

INTERVIEWEE	Position
P1	• P1 is a politician with the title Tun Dr. and the longest serving Prime Minister of Malaysia. He is responsible for the Heavy Industrialisation Programme and the formation of national car company. P1 is a former advisor to Proton (resigned after the research was conducted) and Petronas, a national oil company.
P2	• With the title of Tan Sri, P2 is a senior member of Parliament. He is also former Deputy Prime Minister who served under Prime Minister Mahathir Mohammad
P3	• P3 who hold the title Dato, he is Member of Parliament and also Minister in Prime Minister Department

INTERVIEWEES: BUREAUCRATS

INTERVIEWEE	Position
B1	• B1 is a senior public officer with the title Tan Sri Dr. She is the General Secretary for Federal Ministry but retired recently. She has wide experience in formulating the country's industrial policy
B2	• B2 is a Deputy General Secretary of Federal Ministry and hold the title Dato'. He has been very instrumental in industrial policy planning and implementation for the country
B3	• B3 is a Director General in one of the Prime Minister Office agency. She holds the title Datuk Seri Dr, she has been with the civil service for almost 30 years and has wide experience in economic planning and implementation. She has retired recently
B4	• B4 is a Deputy General Secretary of Federal Ministry. She holds the title Dato and in charge of the financial policy
B5	• B5 holds the title Dato', he is one of the Special Officer to the current Prime Minister.
B6	• B6 is a Deputy Chief Executive Officer for Malaysia government agency. He has involved the country industrial planning and policy formulation for more than decades.
B7	• B7 is a Chief Executive Officer of Malaysia government agency. He is engineer by background and has served national car company before joining the government.

INTERVIEWEES: CORPORATE/BUSINESS GROUPS/BUSINESS ASSOCIATIONS

INTERVIEWEE	Positions
C1	• C1 is a former Member of Parliament. He was also former head of research in one of the government research institute. Currently is Board of Trustee in one of the government linked company.
C2	• C2 is a Chief Operating Officer of government linked company and former CEO of national car company
C3	• C3 holds the title Dato is the President of Business Association representing the car industry especially the

	Bumiputra entrepreneurs. He has involved in various policy consultation
C4	• C4 holds the title Datuk and she is the President of Business Association representing the car industry and also foreign car companies interest. She also represents the country at the ASEAN automotive federation.
C5	• C5 is a Chief Executive Officer
C6	• C6 is former Chief Executive Officer for Malaysia government agency. Now she serves as President in one of the important chamber of commerce in Malaysia. She is actively involved in government economic policy
C7	• C7 is retired Chief Executive Officer. He has been instrumental in development of various automobile engine for national car company. Currently Project Director in one of the automotive company
C8	• C8 is one of the Executive Members for one of the chamber of commerce in Malaysia. C8 hold the title Datuk formerly work with the national car company
C9	• President Japanese Company
C10	• Vice President Japanese Company
C11	• C11 is the President for business association that links to the national car company
C12	• C12 is a Head of Departments Business Development & Event Management for Malaysia International Chamber of Commerce.

INTERVIEWEES: ACADEMICIANS/THINK TANK GROUPS

INTERVIEWEE	Position
A1	• A1 hold the title Tan Sri Dr is a former Member of Parliament. He currently served as Adjunct Professor of Economics and Development Studies in one of the Malaysia university. He involves in various government economic planning and also plays economic advisor role for the National Implementation Task Force. He holds the position as Executive Director of Malaysia Institute Economic Research (MIER)
A2	• A2 is a prominent Professor in economics, his works has been widely cited in political economy and economics research. A2 also plays important role in government economic planning
A3	• A3 is a famous political economist and has published voluminous scholarly work on the country political economy. He is a Professor Department of Administrative Studies and Politics.

Appendix 2

Questions for bureaucracy and Politicians

1. What are the main steps in industrial policy making, specifically in the national automotive policy (NAP)?
2. What would be the main factors considered by policymakers during the policy processes?
3. Do you think that there are groups (for instance business associations local and foreign) that can potentially influence policy-making processes?
4. To what extent are government decisions on the NAP being influenced by the private sectors (foreign and local)? Who has more influence and who has the least influence?
5. How are ideas shaped among policymakers in formulating industrial policy? How does the government prioritise economic interest in policy-making processes? How does the government identify policy themes and who are the main actors influencing this process?
6. Do you feel there is change in government industrial development priority? Why?
7. With regards to the National Automotive Policy (NAP), do you think there are changes in the country's automotive policy? Why?
8. Who do you think can influence government priority in the formulation of the NAP?
9. During the formulation of the National Automotive Policy, how did you prioritise policy interest?
10. Among the actors involved in formulating the National Automotive Policy, who has more influence? Why?
11. Do you feel politicians have more influence in the National Automotive Policy?
12. What are the main challenges in making decisions on the National Automotive Policy?
13. The National Automotive Policy intends to liberalise the automotive industry in Malaysia. How can the national carmaker can be more competitive?
14. Why does the government still need to retain the Approve Permits when the intention of the National Automotive Policy is to liberalise the automotive industry?
15. In your opinion, what is the main challenge for Proton in manufacturing cars?
16. How can Proton overcome its problems to become competitive in the market?

Questions for Private Sectors/Business Associations

1. What do you think of the national automotive policy-making processes in Malaysia?
2. What does your organisation have to do with policy processes?
3. How are ideas shaped, and how do your ideas get to the policy-making processes?
4. What factors influence you in prioritising your interest in the automotive policy-making processes?
5. Do you feel the government considers your interest in policy-making processes?
6. Do you think the formal structure of policy processes is effective enough for you to put forward your interest? Or do you opt for informal discussion with the government officials?
7. With regards to the National Automotive Policy (NAP), do you think there are changes in the country's automotive policy? Why?
8. Who do you think shapes the national automotive policy?
9. Do you think you can influence government priority in the national automotive policy?
10. What are your challenges in promoting policy interest in the policy-making processes?
11. How much does your organisation have to do with the NAP formation? Do you think your organisation can influence the NAP formulation?
12. Who do you think can influence government priority in the formulation of the NAP?
13. Do you feel politicians or bureaucrats have more influence in the NAP?
14. In your opinion, does Malaysia's automotive market represent a level playing field for other automakers?
15. In your opinion, does the NAP favour the national carmakers and their vendors?
16. What do you think about the government's decision to maintain the Approve Permits?

Appendix 3

**School of Sociology, Politics
and International Studies (SPAIS)**

University of BRISTOL

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Interview Consent Form

Research project title:

Research investigator:

Research Participants name:

Thank you for agreeing to be interviewed as part of the above research project. This consent form is necessary for us to ensure that you understand the purpose of your involvement and that you agree to the conditions of your participation. Would you therefore read the accompanying information sheet and then sign this form to certify that you approve the following:

- the interview will be recorded and a transcript will be produced
- you will be sent the transcript and given the opportunity to correct any factual errors
- the transcript of the interview will be analysed by (name of the researcher) as research investigator
- access to the interview transcript will be limited to (name of the researcher) and academic colleagues and researchers with whom he might collaborate as part of the research process
- any summary interview content, or direct quotations from the interview, that are made available through academic publication or other academic outlets will be anonymized
- any variation of the conditions above will only occur with your further explicit approval

Or a quotation agreement could be incorporated into the interview agreement

Quotation Agreement

I also understand that my words may be quoted directly. With regards to being quoted, please initial next to any of the statements that you agree with:

	I wish to review the notes, transcripts, or other data collected during the research pertaining to my participation.
	I agree to be quoted directly.
	I agree to be quoted directly if my name is not published and a made-up name (pseudonym) is used.
	I agree that the researchers may publish documents that contain quotations by me.

By signing this form I agree that;

1. I am voluntarily taking part in this project. I understand that I don't have to take part, and I can stop the interview at any time;
2. The transcribed interview or extracts from it may be used as described above;
3. I have read the Information sheet;
4. I can request a copy of the transcript of my interview and may make edits I feel necessary to ensure the effectiveness of any agreement made about confidentiality;
5. I have been able to ask any questions I might have, and I understand that I am free to contact the researcher with any questions I may have in the future.

____

Printed Name

_____________________________________ _____________________

Participants Signature **Date**

_____________________________________ _____________________

Researchers Signature **Date**